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Letter of Comment No: 5 & File Reference: 1201-100 Date Received: 9-X-DY

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activi
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Reference No. 1201-100

Dear Ms. Bielstein,

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Financial Accounting Standards Board's (the "Board") Exposure Draft, Fair Value Measurements (the "Proposed Standard"). We commend the Board for issuing this Proposed Standard, which we believe is an appropriate first step to achieving more consistent measurements of fair value within existing generally accepted accounting principles ("GAAP").

We believe that the Board's primary purpose of clarifying the fair value measurement objective and its application should result in a conceptual framework for valuation assessments that will enable preparers to determine the best possible estimate of fair value given their individual circumstances. A secondary objective should be the continued education of the Board's constituents on the use and measurement of fair value within existing GAAP. We suggest, however, that to achieve the best possible estimate of fair value, preparers must have the flexibility to apply valuation techniques that appropriately accommodate their unique facts and circumstances and must not be constrained by a requirement to use a specific hierarchy. Accordingly, we suggest the Board consider a slightly modified approach to addressing this topic.

We generally agree with the Proposed Standard's hierarchy to determine the best possible estimate of fair value. However, we recommend amending that hierarchy so that the application of the specific levels within the hierarchy would not be a requirement. Instead, we suggest that a modified approach be used to achieve the best estimate that provides preparers with flexibility. As discussed in the Appendix to this letter, we are aware of a number of situations in which strict application of the Proposed Standard's



hierarchy may not produce the best estimate of fair value. Instead, a best estimate could only be achieved through an approach that permits preparers flexibility to address their unique circumstances. For example, we would amend the concept of active markets with readily and regularly available pricing to include the notion of relevant pricing, as described in the attached Appendix.

Second, we believe there are a number of instances where the Proposed Standard could more clearly describe the underlying valuation concepts to further educate preparers and others. For example, the Proposed Standard's guidance on determining what is and is not an active market for purposes of a Level 1 estimate does not include a discussion of a market's liquidity. We believe that the liquidity of a market should be addressed as part of the determination of the relevant price.

Third, the Proposed Standard includes a number of references to applicable valuation standards and generally accepted valuation practices and includes one specific reference in paragraph C42 to the Uniform Standards of Professional Appraisal Practice and Advisory Opinions issued by the Appraisal Standards Board. Given the increasing use of fair value measurements within GAAP, we believe that these valuation standards and the bodies that issued them deserve further attention by the Board. Accordingly, we recommend that the Board continue its research efforts with the appropriate bodies within the valuation community with the goal of providing further measurement guidance for fair valuing assets and liabilities, improving the consistency of fair value measurements, and further educating its constituents. In particular, we believe that additional efforts are required to address the inconsistent application of the income approach for Level 3 estimates. For example, there continues to be great diversity in practice in measuring the fair value of intangible assets acquired in a business combination and further guidance on the use of the income and cost approaches for those valuations would greatly benefit the financial reporting process.

Our detailed comments in the attached Appendix encompass the above mentioned approach with the overall objective of arriving at the best estimate of fair value. We also address the Board's specific questions on the Proposed Standard.

We appreciate the opportunity to express our views in this letter. If you have any questions regarding our comments, please contact Dave Kaplan (973-236-7219) or Ray Beier (973-236-7440).

Sincerely,

PricewaterhouseCoopers LLP



APPENDIX

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?

We believe that the Proposed Standard provides an appropriate starting point for improving the measurement of fair value under generally accepted accounting principles ("GAAP"). We also believe that the Proposed Standard should help reduce existing diversity in practice regarding fair value measurements. As discussed later in our response letter, we believe that there are certain areas where additional guidance or a modified approach would further facilitate determining the best estimate of fair value.

Frequently, assets and liabilities in a business combination have to be separately measured at fair value when, by their nature, they cannot be exchanged on their own, for example order backlog for proprietary products. We believe the definition of fair value needs to accommodate such assets and liabilities. Additionally, the Proposed Standard's definition of fair value appears to imply that liabilities, like assets, are exchanged. Accordingly, we recommend that the Board consider adopting a modified version of the definition of fair value as stated in International Accounting Standard No. 39 (IAS 39), Financial Instruments: Recognition and Measurement on Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk (Amendment). IAS 39 states that fair value is "the amount for which an asset (or group of assets) could be exchanged, or a liability (or group of liabilities) settled, between knowledgeable, willing parties in an arm's length transaction." For a group of assets or liabilities, the fair value of the individual asset or liability is the contribution of the individual asset or liability to the value as a group.



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 (CON 7), for using present value techniques to estimate fair value (Appendix A). Is that guidance sufficient? If not, what additional guidance is needed?

We believe the guidance in Appendix A regarding the application of present value techniques represents a significant improvement over the existing guidance in CON 7. As noted in paragraph C40 of the Proposed Standard, some constituents have expressed concern regarding the emphasis on the use of the risk-free interest rate for purposes of discounting the expected cash flows to a present value. In our experience, adjustments for systematic or non-diversifiable risk are nearly always reflected in the discount rate and not in the expected cash flows. Thus, we believe that for purposes of clarity, it would be helpful for the Board to note in the Proposed Standard that use of a risk-free interest rate as the discount rate should be limited to those rare instances when expected cash flows take into account systematic or non-diversifiable risk. Additionally, we suggest that the Board include a discussion of its thought process on how to select a risk-adjusted discount rate when using the discount rate adjustment technique and the adjustment for risk when using Method 1 or 2 in applying the expected present value technique in order to improve the consistency in the measurement of fair value.

Additionally, paragraph A21 could be interpreted as a rule requiring preparers to measure the fair value of their liabilities at the amount that the instrument is carried as an asset on the books of the holder. We believe this interpretation is inconsistent with the Board's intentions of developing the best estimate of fair value. We recommend that the Board clarify paragraph A21 to state that the fair value as determined by the asset holder would be one of the many factors that the liability issuer should consider in determining the fair value of the liability, thus enabling the entity issuing the liability to arrive at its best estimate of fair value.



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 believe that the guidance regarding fair values derived from active markets in which the quoted prices are readily and regularly available is a good starting point. As mentioned in our cover letter, we recommend that the concept of fair value refer to "relevant" pricing information in addition to readily and regularly available prices. Relevant pricing encompasses situations in which a quoted market price may not reflect the best estimate of fair value. For example, if an entity is a predominant purchaser of a financial instrument and makes a trade that moves the market just prior to the closing of the market, the closing market price may not be representative of fair value. This phenomenon has occurred with equity securities traded on the National Quotation Bureau (which recently changed its name to PinkSheets LLC) and in the markets for mortgage servicing rights and high-yield bonds. In those types of situations we suggest the Board include the notion of relevant pricing in the Proposed Standard, noting that under certain limited circumstances (e.g., market moving transactions), the closing market price may not be representative of fair value and thus the Level 1 estimate would not be relevant and a Level 2 or 3 estimate should be used. In those types of situations, preparers should have the flexibility of using a Level 2 or 3 estimate because the Level 1 information would not be relevant.

Also as stated in our cover letter, we suggest the Board include a conceptual discussion addressing the impact of a market's liquidity on the determination of fair value and the assessment of a market's placement in the fair value hierarchy. For example, a wide spread between bid and ask prices may be evidence of a thin market. Consequently, the resulting prices may not be relevant and indicative of fair value. Also, due to the illiquidity of the market, the prices might more appropriately be considered a market input to develop a Level 3 estimate rather than a Level 1 estimate (as the Board acknowledges in paragraph 23c of the Proposed Standard)

Finally, we suggest the Board explain the role of active markets outside the United States in measuring fair value. Many U.S. registrants have foreign interests in countries where the markets are less liquid than, for example, the New York Stock Exchange (NYSE), but are still active markets. Furthermore, there are many countries where the market prices are not considered representative or relevant.



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 support the Board's conclusion on selecting an appropriate valuation premise (either going-concern or in-use or in-exchange). However, we note that the definition of fair value as stated in paragraph 4 of the Proposed Standard appears to be inconsistent with the valuation premise discussed in paragraph 13. The valuation premise in paragraph 13 states that an item's fair value could differ if the item is "in-use" versus "in-exchange," yet the definition of fair value in paragraph 4 appears to require an exchange value. We recommend an approach under which financial assets measured at fair value would be valued using an "in-exchange" premise, non-financial assets would be valued using an "in-use" premise, and liabilities would be valued under a "settlement" premise. We believe that this would be consistent with the concept that liabilities are assumed or settled rather than exchanged. For example, consider the valuation of highly specialized equipment for a biotech company. While that equipment has value to the biotech company, a third party may not purchase it. As a result, under the "in-exchange" premise, the asset would have no value; while under the "in-use" premise, the equipment would have a value as determined by one of the cash flow approaches under a Level 3 estimate. With respect to non-financial assets, we have seen circumstances where an acquirer plans to shelve or abandon certain proprietary assets, including brands that a marketplace participant would presumably exploit. In practice, we see entities allocating a value of zero to such acquired assets. If such an acquired asset were to be measured using an "in-exchange" premise and value attributed to such assets, impairment issues would be immediately present. Consequently, we believe the discussion of valuation premise should address the principles underlying the measurement of fair value in such circumstances.



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?

As noted in our cover letter, we believe that a strict application of the hierarchy should not be required. Rather, preparers should begin with Level 1 of the hierarchy and where appropriate work through each of the levels to develop the best estimate of fair value. Preparers should be given flexibility in applying the hierarchy in order to determine the best estimate of fair value.

Additionally, we believe that Appendix B should provide more guidance on the use of Level 2 estimates for financial instruments, particularly on how to consider the differences for similar financial instruments. For example, many financial institutions use matrix pricing to value financial instruments, such as corporate bonds, municipal bonds, and asset-backed securities. Since matrix pricing involves the use of models to estimate the price of a security based upon the prices of a similar security, we are unclear as to whether it might constitute a Level 2 estimate (because of the reference to similar securities) or a Level 3 estimate (because of the use of models in the estimation process). We recommend that the Board clarify this as part of Level 2 or 3 guidance and include an example of a Level 2 estimate for a non-financial asset or liability so that the application of the underlying concepts can be clearly illustrated.

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 agree with the Board's conclusion in the Proposed Standard on the definition of the most advantageous markets. However, as noted in our response to Issue 3, the Board's proposed definition of the reference market does not consider the liquidity of the respective markets in determining the most advantageous price. We believe that the liquidity of the market should be considered in the determination of the reference market and that it is important in applying the concept of relevant pricing. For example, certain



corporate bonds trade on the NYSE, but the active and liquid market is the over-the-counter market, where the price could be higher or lower than the NYSE. Another example relates to equity securities that trade on foreign exchanges, such as an equity security that trades on the NYSE and the London stock exchange. We encourage the Board to clarify this in the Proposed Standard's guidance on the selection of the reference market and add an example that addresses situations such as those where the most advantageous market is not the most liquid market. In that regard, we are unable to think of any circumstances where a Level 1 market could exist when transaction costs are as high as those suggested in Example 5 of Appendix B. While we recognize that these examples are intended to be simplified, we recommend that the Board identify an example of where Level 1 markets exist in spite of high transaction costs or change the illustration to reduce the level of such costs.

We also recommend that the Board explicitly address the apparent conflict between the proposed "most advantageous market" requirement and the guidance provided to investment companies by ASR 118 (FRP 404.03.b.ii), which requires that if a security "is listed on more than one national securities exchange, the last quoted sale, up to the time of valuation, on the exchange on which the security is principally traded should be used" (emphasis added). We believe that a higher volume of trading represents a more liquid market and consequently a more representative price and therefore should be considered for valuation purposes.

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 that for certain financial instruments, such as equity securities or treasury notes that are traded in active dealer markets, bid prices should be used to estimate the fair value of long positions and asked prices should be used to estimate the fair value of short positions. However, this model does not fit all financial instruments on all active markets. For example, certain derivative financial instruments are often priced at a mid-market price and are subsequently adjusted for other factors such as net market positions or credit risk. This is because the bid/ask price for derivatives is often a starting point for negotiations. The mid market price as adjusted is used because preparers believe it is the best estimate of fair value. Consequently, we suggest the Board move away from requiring bid/ask to providing a conceptual discussion or descriptive guidance that would assist preparers in determining if bid/ask is the best estimate of fair value given their

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unique facts and circumstances. Such guidance might be inserted after the first sentence of paragraph 18 and read, "In other cases, events subsequent to the establishment of a bid or ask price may need to be considered in the determining the best estimate of fair value. For example, the bid and asked prices for certain derivative financial instruments may be merely a starting point for negotiations between the parties and would not represent the best estimate of fair value."

In a number of cases (including those in which broker-dealers or other market participants provide quotations for use in periodic financial reporting), broker-dealer quotations represent "indicative bids," i.e., the broker-dealer's view as to the current pricing level at which a transaction would occur, but not necessarily a firm bid-side quotation upon which the dealer itself would enter into transactions. We believe "indicative bids" should be considered Level 3 estimates under paragraph 23 of the Proposed Standard, although we could understand how some may be willing to view them as Level 1 estimates. However, it may be difficult to distinguish "indicative bids" from firm bid-side quotations in lists of quotations provided for periodic reporting purposes. We recommend that the Board provide a framework for how preparers should consider "indicative bids". The alternative would be for the Proposed Standard to explicitly address the categorization of "indicative bids" in the fair value hierarchy.

Finally, we note that many markets have different operating characteristics and that determining the best estimate of fair value should acknowledge those differences. As a result, we believe the Board should include its underlying conceptual thinking in the Proposed Standard regarding the selection of the appropriate market in order to obtain the best estimate of fair value available. For example, most mutual funds use the NASDAQ Official Closing Price (NOCP) to value equity securities traded on the NASDAQ. The NOCP is a normalized price based upon the last reported trade. If the last sale is reported outside the bid and asked prices, the price is adjusted to the nearest prevailing inside quote. NASDAQ's stated reasoning for adopting the NOCP was that, under previous reporting guidelines, the last trade reported was establishing the closing price. Accordingly, slowly-reported trades that may have been outside prevailing bid and ask prices were being reported as closing prices. We believe that the NOCP would be a better estimate of fair value than the bid price for long positions and the ask price for short positions and consistent with the "significant event" criteria described in paragraph 18 of the Proposed Standard it should be viewed as more relevant than bid/ask. If the Board chooses to retain the bid/ask pricing as it is currently stated in the Proposed Standard, we ask the Board to reconcile how the existing pricing practices similar to the NOCP should be considered in the fair value hierarchy.



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?

We agree with the Board's decision to continue to permit current practice under the Guides. However, we encourage the Board to expeditiously move forward and address the block discount issue as well as the broader unit of account issue to remove the inconsistency in practice between those entities that are subject to the Guides and are able to record block discounts and those entities that do not record blocks under Statement of Financial Accounting Standards No. 115, Accounting for Certain Investments in Debt and Equity Securities. For investment companies (other than SEC-registered investment companies, which are entirely prohibited from applying block discounts to securities that can be freely traded on active markets), the current Guide provides a "standstill" on the application of block discounts by any investment company that had not adopted such a valuation policy prior to May 2000. Accordingly, an additional inconsistency exists within the investment company industry itself, which we believe provides a further reason to address this issue expeditiously.



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?

While the examples provided in Appendix B serve as a good starting point for the application of the Proposed Standard and are an improvement over the current guidance, we have a number of recommendations that we believe would improve the Proposed Standard in this area.

Multiple Valuations

We ask the Board to clarify their intent regarding the multiple valuation requirement in paragraph 7 to consider valuation techniques for all estimates of fair value. We note in paragraph 15 that a Level 1 estimate, which is a market approach, must be used if available. Furthermore, we ask the Board to clarify their intent regarding the multiple valuation requirement in Level 3 of the hierarchy. We believe that the multiple valuation requirement in Level 3 should not result in entities measuring each item at each reporting period using three different valuation approaches. In our view, such a requirement would be onerous to companies without necessarily leading to better estimates of fair value. We recommend that the Board carefully consider this important cost/benefit matter and clarify the Proposed Standard accordingly. Furthermore, the fair values resulting from the application of the multiple approaches may be different. The Proposed Standard is unclear about which fair value an entity should select and could result in inconsistent application from company to company depending on the fair value result desired. Additional guidance on determining which approach will result in a more accurate estimate of fair value would help reduce the amount of ambiguity and the potential for inconsistent application of the approaches that may arise.

Valuation of Intangible Assets

As discussed in our response to Issue 1, we believe the Board should expand its guidance on the application of the present value technique for measuring the fair value of intangible assets and reporting units required in the application of Statements of Accounting Standards No. 141 (FAS 141), Business Combinations, and No. 142 (FAS 142), Goodwill and Other Intangible Assets. We believe the Board should address the valuation of intangible assets in the subsequent phase of this project or as a separate project added to the Board's agenda due to the fact that we believe there is an insufficient body of generally accepted valuation standards and principles related to the application of

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the present value technique to measure the fair value of intangible assets and reporting units required under FAS 141 and 142 that allow for the goal of achieving consistent application of fair value measurement. This is especially the case where assets that have to be separately measured at fair value can never, because of their nature, be the subject of a stand-alone current transaction between knowledgeable, unrelated willing parties. We believe such additional guidance is needed from the Board to achieve consistency in the measurement of the fair value of such assets. Most financial statement preparers (sometimes assisted by valuation specialists) measure the fair value of intangible assets apart from goodwill and of reporting units by using the present value technique. Paragraph C42 of the Proposed Standard cites the use of the Appraisal Foundation's Uniform Standards of Professional Appraisal Practice. Those standards provide limited guidance on the use of the present value technique in measuring the fair values of intangible assets apart from goodwill and reporting units. In our view, that guidance is not sufficient to achieve consistent application of the present value technique or to identify the particular cash inflows and outflows that should be considered in the estimate of future cash flows when measuring the fair value of such assets, which is required in the application of FAS 141 and 142. Valuation specialists and financial statement preparers apply a wide range of valuation principles and practices in performing these measurements, including the nature of cash flows that are used. If there are other valuation standards and generally accepted valuation practices aside from those of the Appraisal Foundation that the Board has identified that provide a more robust framework for identifying which cash flows to consider, we do not believe many preparers (or auditors) know of them. For example, if the Board believes that the guidance (or some portion thereof) in Chapter 5, "Valuation of Assets Acquired", of the AICPA Practice Aid, Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on software, Electronic Devices, and Pharmaceutical Industries, is appropriate, it should reference that document along with its existing reference to standards of the Appraisal Foundation.

Cost Approach

The Proposed Standard refers to the cost approach as one of the valuation techniques that shall be considered for all Level 3 estimates of fair value. In our experience, the cost approach can be applied in multiple fashions and while we understand that in practice the cost approach is not always the appropriate method to apply, Level 3 of the hierarchy appears to imply that the cost approach should be applied to all estimates. As a result, we recommend that the Board provide a conceptual discussion addressing when and how to apply the cost approach.

It is also unclear how the replacement cost valuation method can be applied to financial instruments. A financial instrument can only be "replaced" by acquiring the same or equivalent instrument and the acquisition "cost" can only be measured using the "market" or "income" approaches. Thus, for financial instruments, we believe the "cost" approach is inherently circular. It may also give the inference that the "cost method" encourages

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the recording of financial instruments at historical purchase cost as a proxy for fair value. Please see the last paragraph in our response to Issue 10 below.

The use of Level 3 estimates to value financial instruments, such as discounted cash flow analyses, is very common in practice and would be a good example to add to Appendix B. Such an example would help to ensure consistency in applying the fair value measurement objective. Further, we believe Examples 6 to 8 in Appendix B may be too simplistic and not representative of the daily transactions of most preparers. We encourage the Board to add a few additional examples or amend the existing examples to reflect transactions that companies address on a more frequent basis in order to better illustrate the fundamental concepts of the Proposed Standard.

Other

Additionally, many insurance companies use Level 3 estimates for valuing complex embedded derivatives. The hybrid instruments (insurance host with an embedded derivative) are priced individually and occasionally reinsured (securitized) using an industry accepted actuarial approach that uses past experience to predict future uncertainties. The actuarial approach is used because as these instruments are typically much longer in duration than the instruments traded in the capital markets (e.g. they may contain a guaranteed return on the S&P 500 in 15 years, while the capital markets only have information for financial instruments with a guaranteed return of 5 years). Although the capital markets may not have exact information, they may have similar information that can serve as inputs to potential models that might be used to price these long-term instruments. Despite the Board's stated preference for using market inputs in Level 3 estimates, it is unclear whether companies would be required to use market inputs even when these inputs are not exact or whether the hierarchy is intended to allow entities to continue using industry accepted methods for measuring fair value. Clarification would be useful.

We are also concerned that the phrase "without undue cost and effort" in paragraph 21 could result in companies failing to complete Level 3 estimates when such an exercise is not overly burdensome. Companies may have different interpretations of "undue cost and effort," which would result in inconsistent measurements of fair values between entities. Regulatory bodies may not consider such an exercise to be cost prohibitive and require companies to perform the exercise despite the costs and time incurred. As a result, the Board may want to consider removing this phrase or amending it to provide further clarification on the circumstances that would meet this criterion.

Finally, we noted two minor edits to Appendix D of the Proposed Standard. First, it appears that the Proposed Standard is intended to amend paragraph 12 of Statement of Financial Accounting Standard No. 107 (FAS 107), Disclosures About Fair Value of Financial Instruments, based on paragraphs D16e and f of the Proposed Standard.



However, paragraph 12 does not appear in the list of amendments to FAS 107. Second, we observe that footnote 12 of FAS 141 is not amended and we believe that it should be.

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?

It is our experience that the valuation of restricted securities varies widely and that the guidance in ASR 113, while helpful, does not ensure consistency in fair value measurement. We recommend that the Board summarize the underlying concepts that it wishes preparers to consider in the valuation of restricted securities. A discussion of the Board's rationale would greatly assist financial statement preparers as they determine the best estimate of fair value for their restricted security.

Paragraph B17 of the Proposed Standard could be interpreted to suggest that a "restricted security" exists only if an unrestricted class of the same security is available in public markets, reinforced by the first sentence of paragraph B18, "Determining the discount amount requires judgment." We believe that the guidance in ASR 113 and paragraph B18 was not intended to be so limited – rather, it should apply to the valuation of any security that is legally restricted, whether or not unrestricted securities of the same issuer are available. We recommend that appropriate changes be made to clarify this point.

Finally, we believe the references to "cost" in paragraph B18 should mean the historical purchase cost of the investment, not the (replacement) cost method described in paragraph 7c of the Proposed Standard. In our view, that would be consistent with its use in ASR 113. To avoid confusion, we recommend the word "purchase" be inserted before the word "cost" wherever it appears in paragraph B18.



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 agree that for most entities the Board's expanded disclosures would improve the quality and transparency of information provided to users of financial statements. However, for certain entities with trading activities subject to mark-to-market accounting such as broker/dealers, there could be cost/benefit constraints to the disclosure of unrealized and realized gains and losses. Since most financial systems of these entities are not designed to bifurcate the realized and unrealized portions of gains and losses, the costs to modify these systems to capture the appropriate information would be significant. In our view, the costs to make the proposed disclosures would outweigh the benefits received from this information for broker/dealers and other entities with fair value balance sheets.

Additionally, the disclosure requirements refer to valuation techniques for which "market inputs were used." This requirement appears to exclude any disclosure related to valuation techniques where significant entity inputs are used. Fair value measurements that require significant entity inputs are likely to be among the more subjective measurements and, as such, the Board should consider whether information about them should be required disclosure.

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.

We agree that the effective date provides sufficient time for entities to make the necessary changes to implement the Proposed Standard.



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?

As noted in our cover letter and our responses to Issues 3 and 6, the Board should address the concepts of market liquidity and illiquidity discounts on the measurement of fair value for applicable securities and/or instruments that do not have a market in which to trade (e.g. shares of stock held in a private company).

As mentioned in our response to Issue 8, we believe the Board should address the block discount issue and the associated unit of account issues, given the large diversity in practice.

Further, as discussed in Issue 9, we believe the Board should address the general topic of valuing intangible assets in a subsequent phase of the project or as a separate project added to the Board's agenda.

We suggest the Board address the impact of the guidance specified in this Proposed Standard on accounting literature issued by bodies other than the FASB.

We encourage the Board to address the issue relates to EITF 02-03, Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities. We believe that the Board should not wait to address those issues as part of the revenue recognition project as cited in paragraph C23. EITF 02-03 results in significant amounts of revenues being deferred without establishing principles for subsequent recognition of these amounts. The Proposed Standard does not provide needed guidance on how to consider those differences over the life of the instrument.



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 Board offices in Norwalk. Please indicate whether you are interested in participating in the meeting. If so, comments should be submitted before that meeting.

Yes, we would welcome the opportunity to participate. We expect that Ray Beier would be our representative at the roundtable.