



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

File Reference: Proposed FSP FAS 157-e

Dear Mr. Golden:

The Financial Reporting Committee ("FRC") of the Institute of Management Accountants (IMA) appreciates the opportunity to provide its views on the Exposure Draft of Proposed FASB Staff Position No. FAS 157-e Determining Whether a Market Is Not Active and a Transaction Is Not Distressed (the "Exposure Draft"). FRC is the financial reporting technical committee of the IMA. It is comprised of representatives from preparers of financial statements of some of the largest companies in the world and the largest accounting firms in the world, along with valuation experts, accounting consultants, academics and analysts. FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

We support the Board's efforts to provide guidance on when a market is not active and a transaction is "distressed" and therefore does not provide evidence of the fair value of the same or a similar financial asset. While we support the guidance in the Exposure Draft and encourage the Board to finalize the guidance, we have comments on the FSP's presumption that any transaction in an inactive market is a distressed transaction; the operationality of Example 11, as amended; the scope of the FSP; and the proposed effective date.

Presumption of Distressed Transactions

It appears that the Board has traded one bias (usually using the last transaction price) for another (seldom using the last transaction price). We would have preferred the Board provide guidance on how to identify inactive markets and distressed transactions, instead of establishing a presumption that any transaction in an inactive market is a distressed transaction that will be difficult to overcome. We are concerned about the potential ramifications of that decision. In particular, we are concerned that once markets return to normal, the guidance in the FSP will continue to prohibit preparers from using the last





transaction price as support for fair value estimates in certain circumstances. Even in "normal" markets, certain types of financial assets do not trade in active markets. For example, sales of collateralized debt obligations or private equity investments tend to occur in principal-to-principal transactions and there may be little to no information available to determine whether the marketing activities were usual and customary for transactions involving similar assets or whether there were multiple bidders for the asset.

Based on our reading of the Exposure Draft, the FSP would not permit a company to use the transaction price for the sale of the same or a similar security to the one for which it is estimating fair value if it were not able to satisfy both conditions in paragraph 13 of the Exposure Draft. Accordingly, we believe the Board should revise paragraph 13 of the Exposure Draft to give preparers the ability to exercise judgment in determining whether a particular transaction is distressed or not. We suggest modifying paragraph 13 of the Exposure Draft as follows:

If the reporting entity concludes in step 1 that the market for the asset is not active, then the reporting entity will proceed to step 2. In step 2, the reporting entity should determine if a quoted price is associated with an orderly transaction. Information suggesting that a quoted price is associated with an orderly transaction includes (a) the price is associated with a transaction for which there was sufficient time to allow for usual and customary marketing activities for the asset and (b) there were multiple bidders for the asset. The reporting entity should consider all facts and circumstances in determining whether a quoted price reflects an orderly transaction.

Operationality of Example 11

We also believe the Board should provide further guidance on how it believes a company should determine the rates of return in paragraph A32F, as amended, of Example 11 in order to make the example more useful to preparers. We believe the FSP will significantly expand the number of financial assets for which a company estimates fair value using a valuation technique similar to the one illustrated in Example 11. Paragraph A32D indicates that the company would use the discount rate adjustment technique discussed in paragraphs B7 to B11 of FASB Statement No. 157 Fair Value Measurements. Paragraphs B7 to B11 illustrate the application of the discount rate adjustment technique by using the rates of return on similar financial assets. If a company concludes that transactions involving the same or similar financial assets to the one for which it is estimating the fair value are distressed transactions, it will not be able to apply the discount rate adjustment technique as described in Statement 157. The company will not have information necessary to apply the build-up approach illustrated in paragraph B9 of Statement 157 because it only has distressed transactions from which



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to derive the rates of return. Further, we believe the Board should state whether there are circumstances where averaging the two rates of return would **not** be appropriate.

Scope

We note that paragraph 8 of the Exposure Draft limits the application of the FSP to financial assets that a company recognizes at fair value. However, the amendments to Statement 157 reflected in paragraph A1 of the Exposure Draft appear to indicate that the guidance in the FSP applies more broadly. For example, paragraph 29A of Statement 157, as amended, states:

When evaluating whether it is necessary to make a significant adjustment to quoted prices for identical or similar <u>assets or liabilities</u> [Emphasis added]

We recommend the Board clarify the scope of the proposed amendments to Statement 157 to avoid confusion. We would suggest the Board expand the scope of the guidance to include all financial instruments measured at fair value on a recurring basis and financial and non-financial assets and liabilities measured at fair value on a nonrecurring basis. We believe many of the same issues that exist in estimating the fair value of financial assets also affect other types of assets, as well as liabilities. For example, if a company has elected to record its debt at fair value, we do not believe requiring it to use the last transaction price makes sense when the debt does not trade in an active market, particularly when the FSP would require a holder of the debt to estimate fair value using a valuation technique other than the last transaction price.

As another example, in estimating goodwill impairment, a company may use a discounted cash flow approach to estimate the fair value of a reporting unit. If market comparables used to determine the discount rate result from distressed transactions, we believe the Board should permit a company to determine the discount rate using other methods.

Effective Date

We agree that prompt guidance on how to identify distressed transaction is necessary, but we are concerned that the FSP could affect a significant number of financial assets, which would affect a company's ability to determine its fair value estimates in a timely manner. The SEC requires large accelerated filers and accelerated filers to file their Form 10-Q no later than 40 days after the end of the quarter. If a company has a large number of financial assets it has classified in Level 2 of the fair value hierarchy because it uses quoted prices for identical or similar assets in markets that are not active, it may have difficulty selecting and applying an alternative valuation technique and still file its Form





10-Q timely. Companies will need time to determine the most appropriate inputs to their valuation models and will require time to test the controls over how it determined those inputs because of the management attestation requirements under the Sarbanes-Oxley Act of 2002. The disclosure requirements in Statement 157 for Level 3 assets present an added challenge that could cause a company to file its Form 10-Q late, particularly if the company has a significant increase in its Level 3 assets because of applying the FSP. Accordingly, we believe the Board should permit, but not mandate, adoption of the FSP in the first quarter for companies with a calendar year end.

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We would be pleased to discuss our comments further with the Board or the FASB staff. You may contact me at (513) 983-6666.

Sincerely,

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Chair, Financial Reporting Committee