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February 20, 2008



LETTER OF COMMENT NO. 17

Mr. Russell G. Golden
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

Proposed FASB Staff Position No. FSP FAS 157-c, "Measuring Liabilities under FASB Statement No. 157"

Dear Mr. Golden:

We appreciate the opportunity to comment on proposed FASB Staff Position No. FSP FAS 157-c, "Measuring Liabilities under FASB Statement No. 157" ("proposed FSP"). We support the FASB Board's attempts at clarifying the guidance for measuring the fair value of a liability in FASB Statement No. 157, *Fair Value Measurements* (Statement 157). However, we believe that the Board needs to clearly explain the issue it is attempting to resolve through the proposed FSP. We also believe that the proposed guidance appears to be inconsistent with the fundamental principle in Statement 157 that fair value is based on the exit price for an asset or liability.

Objective of the Proposed FSP

We agree with the discussion in paragraphs 2 and 3 of the proposed FSP that the fair value of a liability should be based on the price that would be paid to transfer the liability in a transaction between market participants, rather than an assumed settlement of the liability. However, it is not clear whether the objective of the proposed FSP is intended to clarify that the fair value of a liability should not be based on a settlement assumption or is intended to address some other issue. If the proposed FSP is intended to clarify that the fair value of a liability should not be based on the settlement amount, the FSP should be revised to specifically state that. In addition, we believe that point could be clarified by stating that fair value measurements of liabilities should be made from the perspective of a market participant holding the instrument as an asset and therefore be based on the same principles that would be used in determining the fair value measurement of assets. If the proposed FSP is intended to address some other issue, it should specifically describe the issue that it is intended to resolve and how the proposed FSP would impact the application of Statement 157 to that issue.



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Proposed guidance appears to conflict with the fundamental principle of exit price in Statement 157

One of the key concepts in Statement 157 is that the objective of a fair value measurement is to determine the price that would be received to sell the asset or paid to transfer the liability at the measurement date (an exit price). And paragraph 16 of Statement 157 notes that entities do not necessarily transfer liabilities at the prices received to assume them (i.e. the proceeds received from issuance, which is the entry price) and that fair value should be based on the price that would be paid to transfer the liability (the exit price). However, paragraph 7 of the proposed FSP appears to allow an entry price determination of fair value for liabilities by stating that if a quoted price in an active market for an identical liability is not available, an entity can measure the fair value of the liability at the amount it would receive as proceeds if it were to issue that liability at the measurement date (i.e. an entry price). This appears to be inconsistent with the exit price notion in Statement 157. Accordingly, if the Board retains the guidance in paragraph 7 of the proposed FSP, the Board should explain in the FSP how that guidance relates to the requirements in Statement 157 to use an exit price in fair value measurements and identify the specific circumstances where use of an entry price, rather than the exit price as specified in Statement 157, would be acceptable.

The Board should also address how the guidance in paragraph 7 of the proposed FSP would impact the guidance in paragraphs 8 and 17(d) of Statement 157 regarding situations where the entry and exit markets are not the same (specifically whether the entry market would be considered to be the principal market instead of the exit market) and the guidance in paragraph 31 of Statement 157 on the use of the price within the bid-ask spread that is most representative of fair value (for example, whether a liability such as a short position would be measured at the point in the bid-ask spread at which it could be opened instead of the point at which it could be closed).

If the concept discussed in paragraph 7 of the proposed FSP is retained, we also suggest that the guidance be clarified to state that an entity should value the liability as if it were a new issuance on the measurement date, including a requirement to consider all market conditions that would affect the amount the entity would receive as proceeds on the measurement date, including consideration of any potential lack of liquidity in the market.



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Potential impacts on derivative instruments

The scope of the proposed FSP should be clarified to address the Board's intent on the application of the FSP to the measurement of derivative instruments. A derivative instrument with a fair value or transaction price of zero would not be an asset or liability at initial recognition. Certain financial instruments, such as swaps and other derivatives, may be in either asset or liability positions at different points during the term of the instruments. The Board should clarify whether such instruments are intended to be in the scope of the proposed FSP and whether an entity would be expected to change the measurement of the fair value of the instrument from an exit price model (asset position) to an entry price model (liability position).

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If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419.

Sincerely,

KPMG LLP