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DUFF&PHELPS

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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 157-g

Dear Mr. Golden:

Duff & Phelps Corporation (NYSE: DUF) appreciates the opportunity to provide comments on the Proposed FASB Staff Position FAS No. 157-g, *Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, Investment Companies.*

We would be pleased to further discuss our comments with the Board and staff. Please direct any questions to David Larsen at (415) 693-5330.

Sincerely,

David L. Larsen, CPA Managing Director

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Responses to Specific Questions -- Proposed FSP FAS No. 157-g:

- 1. We agree that the Board should not permit the application of the proposed FSP to investments in entities that have a readily determinable fair value in an active market. However, we believe using the definition in paragraph 3 of Statement 115 is overly narrow because it does not include Funds which are registered and actively traded on exchanges outside the United States. In addition, paragraph 3 of Statement 115 does not incorporate the concept of "active market" from Statement 157. Therefore, confusion may be avoided by specifically stating that the FSP does not apply to interests in Funds which are actively traded on a registered exchange in the United States or other countries.
- 2. Hypothetically, there are circumstances in which an interest in a Fund may initially have a readily determinable fair value because the interest actively trades on a recognized exchange and subsequently does not trade in an active market. It is difficult to point to specific examples, because the concept is hypothetical. Conceptually, FSP FAS 157-4 would apply in such circumstances. If there is a significant decrease in the volume or level of activity of trades, then depending on the facts and circumstances NAV would be used and appropriately weighted with observable orderly transaction prices.

The question as to whether the investor is able to transact with the investee fund at net asset value is also hypothetical. The underlying premise of Statement 157 is determining the amount at which a market participant would hypothetically transact at the measurement date. If the underlying investments of a Fund are valued using the Statement 157 exit market concept, then the investor would receive exactly the NAV if the underlying investments were sold (the premise of Statement 157). Therefore, divining some value other than fair value based NAV is illogical.

- 3. We do not believe the Board should pursue either of the alternative approaches described in Question 3. The alternative approaches are not operational for most Private Equity Funds. Private Equity Funds do not necessarily calculate NAV at the point in time distributions are made. Therefore, the alternative approaches would cause a large number of Funds which the FSP is intended to address to be excluded.
- 4. We do not believe that permitting rather than requiring the application of the proposed FSP would significantly reduce comparability. In almost all cases, unless there is compelling evidence to the contrary, NAV (based on underlying in-phase fair values) provides the best estimate of fair value. Therefore, it is unlikely that preparers would choose not to apply the FSP. We are not aware of any unintended consequences of requiring the application of the proposed FSP.
- 5. The disclosure requirements of the proposed FSP are not operational. It is unclear whether the Board is requiring disclosures by individual investment or by groups of investments (the singular term "investment" is used in paragraph 16, sections b through f, implying the need to disclose individual investments). We believe that disclosures should be in the context of the entire investment portfolio, without providing extensive incremental disclosures for what could be a minor portion of the total investment

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portfolio. The example provided in FSP FAS 132 (r)-1 may provide the basis for providing better guidance on what the Board deems appropriate incremental disclosure.

General Comments to Proposed FSP FAS No. 157-g:

We understand the Board has determined that using Net Asset Value (NAV) to estimate the fair value of an interest in an alternative investment vehicle is considered a "practical expedient." We continue to believe that SFAS 157, as currently drafted, allows for judgment to be appropriately exercised in determining fair value and that NAV, when it meets the key characteristics noted below, is appropriate to estimate the fair value of interests in alternative investment vehicles without using the term "practical expedient." The use of the term "practical expedient" has the potential to confuse readers by providing the impression that NAV, even when appropriately analyzed, cannot be used to estimate Fair Value.

We suggest eliminating the term "practical expedient" and more clearly stating that NAV can be used to estimate the fair value of interests of alternative investments when:

- The Investor has taken appropriate steps to determine that the investment manager calculates NAV based on a rigorous determination of the Fair Value (consistent with SFAS 157) at the measurement date of its underlying investments.
- NAV is "in-phase" (reported NAV is as of the same date as the investors measurement date).
- NAV has been adjusted to take into account the provisions of the AICPA Technical Practice Aid, "Allocation of unrealized gain (loss), recognition of carried interest and clawback obligations".

The Proposed FSP purposely does not provide guidance on the above items, but directs users to the AICPA Investment Company Guide (Guide). While the Guide is helpful, it may not clearly identify several key considerations, discussed below, which would allow an Investor to conclude that the reported NAV is an appropriate basis for estimating Fair Value of the investment.

The January 2009 Draft AICPA Issues Paper "FASB Statement No. 157 Valuation Considerations for Interests in Alternative Investments" contains several key considerations that would help Investors in coming to a Fair Value estimate using NAV. We recommend that the Board determine how best to incorporate these concepts into the FSP specifically, or more generally into GAAP through the codification project. These concepts include (substantially excerpted from the draft issues paper):

- Management of the investor entity must have an effective process and related internal controls in place to ensure a sufficient understanding of its alternative investments. These controls include the following:
 - o Initial due diligence (procedures performed before the initial investment)

- Ongoing monitoring (procedures performed after the initial investment)
- o Financial reporting controls (procedures related to the accounting for, and reporting of, the investment)

(The AICPA Technical Practice Aid: *ALTERNATIVE INVESTMENTS-AUDIT CONSIDERATIONS; A PRACTICE AID FOR AUDITORS* includes examples of these controls.)

- Before placing reliance on the reported NAV as an estimate of Fair Value, the investor entity would need to obtain evidence that the reported NAV is derived from underlying investments being valued consistent with the principles of SFAS 157. Typically, that evidence is gathered via the initial due diligence and ongoing monitoring of the investee fund by the investor entity. For example, the investor entity would consider the following key factors relating to the valuation received from the investee fund manager prior to relying on the reported NAV as an appropriate starting point for a fair value measurement:
 - o The investee fund's fair value estimation processes and control environment, and any changes to those processes or the control environment ¹
 - o The investee fund's policies and procedures for estimating fair value of underlying investments, and any changes to those policies or procedures
 - o The use of independent third party valuation advisors to augment and validate the investee fund's procedures for estimating fair value
 - The portion of the underlying securities held by the investee fund that are traded on active markets
 - The professional reputation and standing of the investee fund's auditor (this is not intended to suggest that the auditor is an element of the investee fund's internal control system, but as a general risk factor in evaluating the integrity of the data obtained from the investee fund manager)
 - Qualifications, if any, of the auditor's report on the investee fund's financial statements
 - Evidence that the reported NAV is based on application of FASB Statement No.
 157 as of its calculation date
 - Whether there is a history of significant adjustments to the NAV reported by the investee fund manager as a result of the annual financial statement audit or otherwise
 - o Findings in the investee fund's advisor or administrator's SAS 70 report, if any
- Only after considering these and other factors relevant to the valuation received from the investee fund manager can the investor entity reach a conclusion about whether the

For further guidance, see AU Section 332, *Auditing Derivative Instruments* (AICPA, *Professional Standards*, vol. 1), and the *Alternative Investments - Audit Considerations* practice aid.

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reported NAV of the investee fund is an appropriate basis for estimating Fair Value of the interest.

- After the investor entity determines that the reported NAV is derived using the Fair Value of underlying investments, it may be necessary to adjust the reported NAV for factors that would cause it to differ from the fair value of the interest in the alternative investment. For example, the following factors might necessitate an adjustment to the reported NAV:
 - Significant time has elapsed between the calculation date of the reported NAV and the investor entity's financial reporting (measurement) date, and any of the following circumstances exist:
 - The investor entity has made an additional investment(s) since the calculation date of the reported NAV and prior to the investor entity's measurement date;
 - The investor entity has received a distribution(s) or partial redemption since the calculation date of the reported NAV;
 - The investor entity has become aware (through inquiry of the investment manager or communication by the investment manager to the investor entity) of changes in the value of underlying investments since the calculation date of the reported NAV;
 - Market changes or other economic conditions have changed to favorably or unfavorably affect the value of the investee's portfolio after the calculation date of the reported NAV;
 - Significant changes have occurred in the composition of the underlying investment portfolio of the investee fund after the calculation date.
 - O Differences between the accounting standards or processes used by the investee fund to compute the reported NAV and those used to compute the NAV for capital transactions (issuances and redemptions). For example, (a) in computing the NAV used for redemptions, the investee fund may amortize organization costs but, in its reported NAV, which is based on GAAP, expenses them, or (b) in computing the NAV used for redemptions, the investee fund uses a different investment valuation method than it uses in computing the reported NAV, which is consistent with GAAP.
 - Significant balance sheet items (such as term debt) not carried at fair value for NAV computation purposes (to the extent debt would be repaid at an amount other than carrying value).
 - Unrealized profits allocated on a pro-rata basis rather than a hypothetical liquidation basis (that is, the allocation of profits assuming a sale of the portfolio at the values reported on the measurement date).

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The focus is on the standards used for computing the NAV that will be used for capital transactions (trading NAV) as compared to the reported NAV because the trading NAV represents the amount an investor in the fund would ultimately receive in cash.

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It should also be noted that a significant number of investors in alternative assets report under GASB Standards. The Board should consider recommending that GASB provide guidance to GASB reporters on whether or not it is appropriate to utilize concepts from Statement 157 and FSPs such as FSP FAS 157-g in valuing alternative assets in accordance with existing GASB standards.

Specific Comments to Proposed FSP FAS No. 157-g:

We offer the following specific comments and suggested changes to the proposed FSP:

Paragraph 12:

The words "This FSP applies to investments in entities that meet the definition of an investment company; ... for which the entity's net asset value per share ... has been calculated in accordance with the Guide" could be misunderstood and misinterpreted. "Meet" and "in accordance with" may be interpreted to mean that a fund must apply the Guide. We recommend the wording be modified to encompass all funds, including foreign funds who calculate net asset value per share (partners capital) "substantially consistent" with the Guide.

Paragraph 13:

Paragraph 13 is confusing. More clarity would exist if the reference to SFAS 115 in paragraph 12 was eliminated and paragraph 12 and 13 were combined to specifically state that the FSP does not apply if the fair value of the investment is readily determinable because the interest actively trades on a regulated exchange or in an over-the-counter market.

Paragraph 15:

The opening sentence of paragraph 15 "In circumstances in which net asset value per share of an investment is not determinative of fair value..." is confusing. We recommend deleting these words and starting the paragraph with "A reporting entity is permitted..."

We agree with the Board that NAV must be "as of the reporting entity's measurement date" for the FSP to be applicable. However, because investor entities do not necessarily receive reported NAV with sufficient time prior to the investors measurement date, a large number of investments would not qualify to be valued using the FSP, as currently written. No clear guidance would exist on how to value such investments in accordance with GAAP. As such, we recommend that the Board amend the FSP to allow investors to estimate NAV as of the measurement date using the factors outlined in our general comments above.

Paragraph 16:

As noted in our answers to the Boards specific questions, we believe the disclosure requirements are confusing and not operational. To remove confusion, the Board should specifically state whether investments may be aggregated. Disclosing the information requested in paragraphs 16 a-f on an individual investment basis would be problematic for investors, many of which invest in hundreds of individual investments. The Board should also consider providing an example of

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disclosures. The example shown in FSP FAS 132(r)-1 could be a good starting point for showing aggregated disclosures, with relevant information from paragraphs 16 a-f being footnoted.

Paragraph 17:

Depending on the timing of issuance, the immediate effective date of the FSP may not be operational. Many pension plans are required to file their form 5500 on July 31. Public Corporations complete their 2nd quarter disclosure in early August. It is unlikely that the disclosure requirements can be met in a compressed timeframe assuming issuance date of late July. Therefore, we recommend delaying release of the FSP until August 15 or amending the effective date to take into account the above timing issues.