

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

September 7, 2010

Reference: FASB Reference No. 1830-100, *Proposed Accounting Standards Update Fair Value Measurements and Disclosures (Topic 820) Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*

Dear Mr. Golden:

Duff & Phelps appreciates the opportunity to provide comments on the above referenced exposure draft and the associated questions raised by the Board.

Our valuation advice, particularly with regards to financial reporting, is sought by hundreds of global clients annually as we work with them in developing pragmatic solutions for applying fair value techniques that are acceptable to the public accounting community. We believe that our unique perspective in the practical application of valuation related accounting principles -- both under United States generally accepted accounting principles (U.S. GAAP) and international financial reporting standards (IFRS) -- has particular relevance to the Board and its constituency -- as it relates to the proposed accounting standard referenced above.

We would be pleased to further discuss our comments with the Board and staff. Please direct any questions to either of us via the contact information set forth below.

Sincerely,



Paul Barnes
Global Leader – Valuation Advisory
Services and Office of Professional
Practice



David L. Larsen, CPA
Managing Director

cc: IASB
Comment letters
30 Cannon Street
London, EC4M 6XH
United Kingdom

Reference: Exposure Draft: *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (Limited re-exposure of proposed disclosure)*

Duff & Phelps Corporation (NYSE: DUF) is a leading independent valuation consultancy and financial advisory firm

Responses to Specific Questions

Listed below are certain of the Boards' specific questions raised in the EDs and our responses thereto.

FASB Question 1. *This Exposure Draft represents the Board's commitment toward developing common fair value measurement guidance with the IASB. Do you think the proposed amendments:*

- (a) Would improve the understandability of the fair value measurement guidance in U.S. GAAP? If not, why not?*
- (b) Would result in any unintended consequences on the application of the proposed amendments? If so, please describe those consequences.*

Duff & Phelps response. We strongly agree with the FASB (the Board) and IASB's overall goal to establish a common fair value measurement and disclosure framework which will result in consistent and comparable fair value measurements and disclosures for both US GAAP and IFRS.

However, we are very concerned that the proposed changes to ASC 820 via the proposed ASU (the Fair Value ED) will:

- Result in a number of unintended consequences,
- Change current practice,
- Reduce consistent application of principles, and
- Cause a change in fair value estimates inconsistent with a market participant perspective.

We have described these concerns in our responses below.

FASB Question 2. *The Board has decided to specify that the concepts of highest and best use and valuation premise are only to be applied when measuring the fair value of nonfinancial assets. Are there situations in which those concepts could be applied to financial assets or to liabilities? If so, please describe those situations.*

Duff & Phelps response. We do not agree with the Board's proposal. The concepts of highest and best use and the "in-use" valuation premise are applicable to many financial instruments which market participants transact on a "group" basis, including tranches of an entity's capital structure and working capital, to name a few. The elimination of the group notion can in some cases have a profound and far-reaching effect on the fair value measurements recorded in the financial statements and will create a significant burden of effort for preparers by forcing fair value to be estimated on a basis other than a market participant perspective.

The resulting fair value measurements could significantly differ from current fair value estimates that use a market participant perspective. The individual instrument “new fair value” would not be better or more decision-useful for financial statement users as it would fail to reflect the manner in which market participants would transact for certain assets and liabilities.

We believe that applying a market participant perspective in estimating the fair value of financial instruments should take into account an entity’s business model when identifying the unit of account and unit of valuation for the fair value measurement. Despite the fact that it espouses a market participant perspective, the current proposal in the Fair Value ED fails to address the following three key points:

- **Business model.** The accounting treatment and approach to the measurement of financial instruments (in addition to other types of assets and liabilities) should integrate the underlying business model and operations with the assets and liabilities necessary to execute the business strategy. Understanding and taking into account the business model employed by management allows all interested parties to be adequately informed and enables them to better evaluate the entity’s strategic decisions and operations on a consistent and comparable basis. Business model assumptions are used by market participants in determining the appropriate unit of account and unit of valuation. The Fair Value ED does not allow for such market participant assumptions to be taken into account for all types of assets and liabilities.

- **Unit of Account and Unit of Valuation.** The unit of account concept is central to the measurement of fair value. However, in practice, the unit of account is inconsistently determined and often does not reflect a market participant perspective. Therefore, any new fair value guidance must clearly and appropriately articulate the unit of account or make the necessary amendments to the relevant ASC topic to improve the consistency of fair value measurements among reporting entities. As noted above, an entity’s business model is a primary factor considered by market participants in establishing the appropriate unit of account and unit of valuation. The unit of valuation provides the context (or the level of aggregation) in a hypothetical transaction.

- **Operationality.** Compliance with the Fair Value ED, in conjunction with the proposed changes in the Financial Instruments ED recently issued by FASB would require major changes to the accounting systems underlying the reporting process for financial instruments, particularly for loans. Through our interactions with numerous clients we feel confident in saying that few, if any,

financial institutions or corporate industrial companies will have the necessary systems or detailed records to perform the accounting being proposed by the Board as result of the juncture of the Fair Value ED and the Financial Instruments ED. Even though underlying systems may capture certain information at an individual asset level, market participants may transact at a group level, making a “group” the appropriate unit of account for determining fair value.

Below we provide a few specific examples of the breakdown between the market participant perspective and fair value measurements resulting from the Fair Value ED:

- It is common for market participants to value consumer and mortgage loans based on a “highest and best use” valuation premise where the loans will be pooled and sold into the securitization market. As a result, fair value is modeled based on the securitization value of the resulting loan pool adjusted for costs to transform the loans to the security form. If the Fair Value ED proposals are not revised, a market participant view could not be employed as such loans would be valued based on the whole loan market rather than as “grouped” in the securitization market.

If the valuation premise is restricted to in-exchange only, then arguably, the securitization market may not come into consideration as loans cannot be securitized on a one-off basis, or at least not with the same lift in value to achieve value maximization. This would be both counter-intuitive and inconsistent with the highest and best use of such portfolio of financial assets. It may also potentially eliminate an entire class of market participants that would have been considered in the fair value measurement of the asset.

- In cases in which an Investment Company (Alternative Asset Investment Fund) invests in more than one tranche of an investee company’s capital structure, such as both private debt and private control equity, the proposal would result in each instrument being valued independent of the other.

While each asset (the investment in debt and the investment in equity) may be ascribed a separate value for financial reporting purposes (separate units of account), current practice is to use the market participant perspective such that any transaction would include both the debt and equity investments (as a unit of valuation, transacted together in-use), because generally in such circumstances, debt must be repaid upon a change of control by

the equity holder. Therefore, from a market participant perspective, the overall enterprise value is first estimated. The fair value of debt is then estimated based on the amount that would be repaid at the measurement date (the fair value of debt would generally equal the contractual obligation, or par value of the debt, given that the call feature associated with the debt moves the theoretical term to zero). Finally the fair value of equity would equal the enterprise value, less the contractual amount of debt to be repaid (the fair value of debt per the above analysis).

By eliminating the concepts of highest and best use and in-use valuation premise, we are concerned that the market participant perspective described above could no longer be applied as the debt investment would be valued independently of the equity investment. As a result, when valuing debt in the scenario above, some would conclude that a market participant perspective assessing the term of the debt as zero cannot be used because it cannot be assumed that the debt would be refinanced concurrent with the sale of equity (even though contractually it must be repaid upon a change of control). In addition, the fair value of equity may be misstated from a market participant perspective, because the value of equity would be estimated using a theoretical fair value of debt (valued completely independent of other factors), rather than the fair value of debt estimated using market participant assumptions (which would include the specific call feature).

Further, it should be clear that if an investor “controls” an entity, the allocation between debt and equity may be fully within the purview of the control shareholder. A control shareholder can direct what is equity and what is debt in an investee company’s capital structure. The Board’s proposal eliminates the ability to view all aspects of the capital structure from the market participant perspective, as the changes force fair value to be determined individually for each instrument.

In contrast to the above, ASC 350 specifies the unit of account to be the reporting unit in performing the goodwill impairment test. Whether the test is performed at the equity or enterprise level (as a unit of account), the context (unit of valuation) is the business, as the test contemplates a hypothetical sale of the business. Thus, to the extent the valuation of any interest-bearing debt is required as part of the analysis, the assumptions would allow the obligation to be viewed either at par or valued based on current interest rates, depending on the provisions of the debt agreement. This approach is consistent with the way market participants would view the debt, and could not be applied if the unit of account/unit of valuation for the impairment test was not appropriately specified.

Therefore, *in finalizing the Fair Value ED it is also critical that the Board specify the appropriate units of account in other ASC topics where fair value measurements are required (or permitted)*. Such specifications should be made consistent with the manner in which market participants would view such assets and liabilities (often as part of a group, or a business, and consistent with the entity's business model).

- The proposed change would also impact the valuation of working capital in the context of a business combination. The components of working capital are generally viewed by market participants together, as a group. Under the proposal, such working capital components would be valued on a standalone basis, rather than as a group.

Requiring the analysis of the elements of working capital on a standalone basis would require the use of specific inputs to reflect an in-exchange premise (e.g., possibly the use of factoring adjustments for the receivables). This would not only be inconsistent with the way the marketplace views such instruments but it would also not meet the cost-benefit tradeoff in applying fair value.

In summary, we observe that, ASC 946, ASC 825, the Board's recent Financial Instruments ED and the Fair Value ED do not contain sufficient unit of account and unit of valuation guidance to effectively address the concerns outlined above.

Nonfinancial Liabilities – Highest and Best Use and Premise

The guidance in the Fair Value ED also eliminates the ability to use highest and best use and the in-use valuation premise with respect to nonfinancial liabilities. We believe that in concept, a notion similar to highest and best use and premise (in-use) is applicable to liabilities. To the extent the transferee of a nonfinancial liability is assumed to have the requisite assets (property, plant & equipment technology, workforce, etc.) in place to fulfill the liability, the obligation can be effectively viewed as being "in-use" with such group of assets. In the absence of its complementary assets, the fair value measurement of the liability may differ (e.g. due to a learning curve that would have to occur before the liability could be satisfactorily fulfilled.)

FASB Question 4. *The Board has decided to permit an exception to fair value measurement requirements for measuring the fair value of a group of financial assets and financial liabilities that are managed on the basis of*

the reporting entity's net exposure to a particular market risk (or risks) (that is, interest rate risk, currency risk, or other price risk) or to the credit risk of a particular counterparty.

a. Do you think that proposal is appropriate? If not, why not?

b. Do you believe that the application of the proposed guidance would change the fair value measurements of financial assets and financial liabilities that are managed on the basis of the reporting entity's net exposure to those risks? If so, please describe how the proposed guidance would affect current practice.

Duff & Phelps response. We generally agree with the Board's decision, but we believe the circumstances outlined in the proposal, which permit grouping, are too limited. The Board's proposal identifies an exception to individual fair value measurement for a narrow group of assets and liabilities managed on a net exposure basis. As noted above, to the extent market participants would view such assets and liabilities on a group or net basis, we agree with the proposed treatment.

As we have previously explained in our response to Question 2, there are other situations where a group of assets (or a group of assets and liabilities), would be the basis of valuation by market participants. It is not consistent to allow grouping of certain assets and liabilities managed together, while prohibiting the grouping of other assets (or assets and liabilities) which are valued (or transacted) on a combined basis by market participants.

FASB Question 5. *The Board has decided to clarify the meaning of a blockage factor and to prohibit the use of a blockage factor when fair value is measured using a quoted price for an asset or a liability (or similar assets or liabilities). Do you think that proposal is appropriate? If not, why not?*

Duff & Phelps response. We do not agree with the proposed change. The Board defines the term "blockage"¹ very narrowly as only relating to the market's ability to absorb a position. The concept of blockage is thus implicitly considered only in terms of discounts (i.e. the premium that a block of instruments might command is not blockage). Meanwhile,

¹ Unless otherwise used in the context (or limitations) of the specific paragraph, "blockage" is used by us to also include scale or significant size relative to 'normal' trading volumes of comparable instruments.

investors generally use the term “block” or “blockage” in a wider context. The Board defines blockage in paragraph 820-10-35-36C of the Fair Value ED as:

“...a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) [where] a quoted price for the asset or liability (or similar assets or liabilities) [is used] as an input into a fair value measurement, the quoted price for the asset or liability shall not be adjusted because of the size of the position relative to trading volume (commonly referred to as a blockage factor).”

Market participants use the concept of blockage in a wider context. Equity financial instruments², especially illiquid investments, or non-traded (private) investments are generally purchased and sold as a block, at times with a blockage discount or a blockage premium³. In practice, the lack of blockage guidance for Levels 2 and 3 has allowed the application of blockage adjustments (typically in the form of a control premium) in valuing equity instruments to reflect the market participants’ perspective. However, paragraph 820-10-35-36B of the Fair Value ED may lead to valuations on a ‘minority basis’ (individual share basis) in the above situations as it does not allow this use of the broader definition of a block. The ability to use a control premium is subject to the existence of appropriate unit of account guidance in U.S. GAAP which in many cases is silent on the issue.

Further, the Fair Value ED does not prohibit a blockage premium. Some will interpret this silence as allowing blockage premiums (consistent with the broader interpretation of blockage in the marketplace), while others will interpret the wording as prohibiting the use of any and all blockage adjustments, resulting in divergent practice.

Differentiating blockage from illiquidity on an individual equity instrument basis may be challenging. For example, if similar instruments are traded in blocks (Level 2 inputs are available) and one is attempting to derive a fair value for the instrument being measured, it may be difficult to extract the “blockage element” from the observed price for the block, while leaving in the “illiquidity element” that pertains to the individual instrument. That is,

² From a fixed income perspective, most financial instruments transactions are single unit, i.e. corporate bonds, treasuries and agencies. There is a scale premium/discount for size analogous to blockage (typically a premium).

³ The Fair Value ED states that an entity would only incur a blockage discount when it sells a position, and the discount is likened to transaction costs, a penalty of sorts because of the decision to sell. We disagree with this perspective because instruments are not only sold, but also purchased in blocks, and market participants may not typically transact in the individual instrument.

adjusting the observed price for the effect of blockage may be challenging, if not impossible, when the equity instrument trades in blocks.

We understand that the Board's intent is to allow grouping of securities for measurement purposes to the extent a market participant would group such securities, at least in Levels 2 and 3. However, the proposed wording in paragraphs 820-10-35-36B and 36C of the Fair Value ED, as written, appears to be in conflict with the Board's intent.

From a fixed income instrument perspective, we also believe that both scale (or blockage) and illiquidity are very real factors that market participants take into account (even with regard to Level 1 assets). In some cases, such factors, which can be analogized to concentration risk, are more significant than counter-party risk. The Board's desire to exclude blockage and illiquidity is inconsistent with its goal of valuing an asset (or liability) using a market participant's perspective.

Finally, from a conceptual point of view, as stated in some of our prior comment letters to the Board, and relating to both equity and fixed income instruments, we observe that while there might be some justification in prohibiting blockage factors on the grounds of reliability (verifiability) of the measurement in Level 1, this view does not support extending the blockage prohibition to all levels of the fair value hierarchy, as the measurements requirements for Level 2 and 3 assets suggest that adjustments to observable inputs, and/or the use of a valuation technique be considered. The Board's rigid focus on reliability dissipates with respect to Level 2 and 3 assets. Therefore, the degree of measurement verifiability, under the Board's proposal, is not improved, and more importantly, the true economics of the block from a market participant's perspective is compromised.

In summary, we recommend allowing the concept of a block using the wider market participant definition in Levels 2 and 3 of the fair value hierarchy to correct this conflict. We also recommend a reconsideration of the prohibition of blockage in Level 1.

Question 6. *The Board has decided to specify that other premiums and discounts (for example, a control premium or a noncontrolling interest discount) should be taken into account in fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy when market participants would take into account those premiums or discounts when pricing an asset or a liability consistent with the unit of account for that asset or liability.*

a. Do you think that proposal is appropriate? If not, why not?

b. When the unit of account for a particular asset or liability is not clearly specified in another Topic, how would you apply that proposed guidance in practice? Please describe the circumstances (that is, the asset or liability and the relevant Topic) for which the unit of account is not clear.

Duff & Phelps response. From the perspective of equity instruments, we agree. Moreover, we believe that Board should emphasize that all features of an asset, including control, should be considered from a market participant perspective. We are concerned, however, that the proposed language will not achieve the desired outcome, specifically as applied in an investment company context.

For example, as noted in paragraph 820-10-35-36B of the Fair Value ED:

“A reporting entity shall apply a control premium when measuring the fair value of a controlling interest in another entity when another Topic specifies that the unit of account is the controlling interest and the reporting entity determines that market participants would consider such a premium when pricing that controlling interest.”

Accordingly, Investment Companies, in complying with ASC 946 report all investments at fair value. However, ASC 946 does not directly articulate that “the unit of account is the controlling interest.” Therefore, alternative asset funds would arguably be forced to value investments on an individual instrument basis, rather than on the basis used by market participants. We believe that as currently drafted, the Fair Value ED will result in inconsistent estimates of fair value. We understand and agree with the Board’s intent to ensure that all features of an instrument, including control, are properly included in the determination of a fair value estimate. However, because of the elimination of the concept of highest and best use and valuation premise, and because of the prohibition of valuing a block (group), the proposed changes would likely force individual share valuations which would preclude considering the value of a control feature.

Further, we recommend that the Fair Value ED carefully articulate the notion of a control premium (and its inverse, a noncontrolling interest discount) by further expanding upon the notion that one should be applied when market participants would consider one in the circumstances. Specifically, in some cases the control (noncontrolling) assumptions may be already “baked into” the cash flows or other assumptions used in the valuation, or represented in a price paid. (The same principles apply to marketability discounts as well). Meanwhile, in other circumstances, such as a reporting unit valuation for the purpose of impairment testing under ASC 350, a control premium may need to be discretely applied to a minority share price (or a noncontrolling basis value), where appropriate.

For our additional concerns surrounding the lack of unit of account guidance and the prohibition of the concepts of highest and best use and premise for financial instruments, please refer to our repose to Question 2.

FASB Question 7. *The Board has decided to require a reporting entity to disclose a measurement uncertainty analysis that takes into account the effect of correlation between unobservable inputs for recurring fair value measurements categorized within Level 3 of the fair value hierarchy unless another Topic specifies that such a disclosure is not required for a particular asset or liability (for example, the Board has decided in its project on the accounting for financial instruments that a measurement uncertainty analysis disclosure would not be required for investments in unquoted equity instruments). Do you think that proposal is appropriate? If not, why not?*

Duff & Phelps response. We address equity instruments, fixed income instruments and nonfinancial assets separately in our response below.

Equity Instruments

We understand that the Board's Financial Instruments ED would exempt investments in equity securities of private companies from measurement uncertainty disclosure. We agree with this exemption for a number of reasons, including the use of non-homogeneous inputs across the investments leading to potential aggregation issues in disclosure (i.e. aggregating end ranges of dissimilar items). However, if the Fair Value ED is implemented before the Financial Instruments ED, there could be a period during which disclosures about measurement uncertainty would be required for investments in equity securities of private companies only to be later eliminated by the Financial Instruments ED, which may not be effective for many investment companies until 2017. Therefore, the exemption for investments in equity securities of private companies from the measurement uncertainty disclosures should be incorporated in the amendments to ASC 820 as part of the revised fair value guidance.

Fixed Income Securities

In the fixed income markets, it has been standard practice to perform sensitivities on various inputs (e.g. changes in interest rates, prepayment rates, default curves, etc.). This being an established practice, together with the types of (macro) inputs considered in the sensitivities which may impact multiple fixed income products in a similar fashion, makes the measurement uncertainty disclosure relatively less problematic and meaningful on an asset class level.

However, we recommend that the Board consider exempting fixed income securities in private companies from the above disclosure as private debt investments are much more correlated with the performance of the individual private company, and therefore may use less homogeneous inputs which would result in less meaningful aggregate disclosures.

Nonfinancial Assets

While the measurement uncertainty disclosure applies only to recurring fair value measurements under the Fair Value ED, we understand that the IFRS fair value exposure document does not distinguish between recurring and nonrecurring fair value measurements subsequent to initial recognition. Thus the measurement uncertainty disclosure requirement may apply to fair value measurements under IAS 16 (property, plant & equipment; if fair value can be measured reliably), IAS 38 (intangible assets; if an active market exists); and IAS 40 (investment property). Of these various categories, we expect that in practice, the disclosure would most often be applied to investment properties carried at fair value. Since FASB has a project on its agenda in which it is considering a fair value option for investment properties, similar disclosures may be required in the future in U.S. GAAP as well. In general, we do not perceive any significant issues in providing measurement uncertainty disclosures for investment properties.

Below are a few concerns related to the proposed measurement uncertainty disclosures in general:

Entities Using NAV

The example provided on p. 127 of the Fair Value ED seems to imply that an entity which invests in venture capital, private equity or hedge funds and most likely uses Net Asset Value (NAV) as a practical expedient for estimating fair value of those investments would need to provide the measurement uncertainty disclosures. ASU 2009-12 already requires extensive disclosure for such assets. We are concerned that information needed for the new proposed measurement uncertainty disclosures is not available to investors (preparers). This is because the underlying fund itself, which generally would be an investor's primary source of information, would not be required to provide measurement uncertainty disclosures for its investments in private companies due to the exception in the proposed Financial Instruments ED.

Therefore we recommend that entities that use NAV as a practical expedient should be exempted from the proposed measurement uncertainty disclosures.

Reasonable Alternative Inputs

The extent of what ‘reasonably’ constitutes (inputs “that could have reasonably been used in the circumstances”) may be open to judgment and wide interpretation, as it is only clear that it excludes remote scenarios. Thus, measurement uncertainty analysis will be to a large degree a function of auditor and regulatory interpretation, especially in the U.S. where independent auditors and regulators historically have operated in a rules-based accounting standards framework. Until a level of comfort with the use of judgment in applying principles-based guidance increases, we are likely to continue to encounter tension in the application of fair value concepts.

Evaluating Significance

The articulation of the meaning of “significant” and “significance” continues to be confusing. On one hand, the guidance requires analysis of inputs that could have reasonably been used in the circumstances and would have resulted in a **significantly higher or lower fair value measurement**. In the above iteration, significance is judged with respect to the individual fair value measurement (whether related to a single asset or group of assets measured at fair value, depending on the unit of account). It should be noted that the interpretation of the meaning of significance relating to the individual fair value measurement is also consistent with the concept as articulated in ASC Topic 820, which states:

“The level in the fair value hierarchy within which the fair value measurement in its entirety falls shall be determined based on the lowest level input that is **significant to the fair value measurement in its entirety** [emphasis added]. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.”

On the other hand, the benchmark for significance in the Fair Value ED is based on **earnings (or changes in net assets) and total assets or total liabilities**. If the intent is to determine significance based on earnings and total assets or total liabilities, then the question becomes:

Should the effect of the change in a particular input be considered in the aggregate for a group of assets measured at fair value (for example, high-yield debt securities)?

While a change in a single key input (e.g. discount rate) may not change the fair value of an individual asset (or group of assets) significantly relative to the total assets of the entity, such an input modification may cause a significant change in the fair value measurements of a class of

assets when its effect is considered in the aggregate. If this is the objective the Board has intended, it may need to clarify its guidance in paragraph 820-10-50-2f of the Fair Value ED as follows (suggested insert is underlined):

“If changing one or more of the unobservable inputs used in a fair value measurement to a different amount that could have reasonably been used in the circumstances would have resulted in a significantly higher or lower fair value measurement for the asset (liability) class, a reporting entity shall disclose the effect of using those different amounts and how it calculated that effect.”

IASB Question 1: *Are there circumstances in which taking into account the effect of the correlation between unobservable inputs (a) would not be operational (eg for cost-benefit reasons) or (b) would not be appropriate? If so, please describe those circumstances.*

Duff & Phelps response. On an individual asset/liability basis, taking into account correlation among the inputs should not be problematic, as all inputs are evaluated for coherence as part of the fair value measurement process. However, as the effort is expanded to meaningfully cover all assets and liabilities in an asset class, the complexity of this requirement becomes a function of the relative homogeneity of the inputs and the asset class (e.g., this may be easier to apply it to a fixed income class of instruments than to equity instruments).

IASB Question 2: *If the effect of correlation between unobservable inputs were not required, would the measurement uncertainty analysis prove meaningful information? Why or why not?*

Duff & Phelps response. No. Excluding correlation among the inputs in a sensitivity analysis would not be helpful and may not be meaningful, unless financial statement users are interested in one particular input under the facts and circumstances. This then raises the question whether multiple sensitivities should be provided for different inputs.

We also note that the observable inputs can also vary within a range; therefore it does not seem appropriate to exclude the observable inputs when considering the correlation as part of a sensitivity analysis.

FASB Question 8 & IASB Question 3. *Are there alternative disclosures to the proposed measurement uncertainty analysis that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy that the Board should consider*

instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.

Duff & Phelps response. ASC 820 already requires a description of the valuation technique(s) and the inputs used for Level 2 and 3 fair value measurements.

As an alternative to the quantitative measurement uncertainty disclosures for Level 3 measurements, possibly providing a *qualitative* discussion of why the specific inputs were chosen in preference to other inputs on a relevant asset grouping level could provide sufficient information for financial statement users to evaluate the rigor applied in estimating fair value.

Question 11. *The amendments in this proposed Update would apply to public and nonpublic entities (that is, private companies and not-for-profit organizations). Should any of the proposed amendments be different for nonpublic entities? If so, please identify those proposed amendments and describe how and why you think they should be different.*

Duff & Phelps response: As stated above, we believe that non-public investors in alternative asset funds (pension funds, endowments, etc.) already provide robust disclosures in accordance with ASU 2009-12 and should be exempted from the proposed measurement uncertainty disclosures. We are concerned that information needed for the new proposed measurement uncertainty disclosures is not available to investors (preparers). This is because the underlying fund itself, which generally would be an investor's primary source of information, would not be required to provide measurement uncertainty disclosures for its investments in private companies due to the exception in the proposed Financial Instruments ED.

Question 12. *How much time do you think constituents would need to prepare for and implement the amendments in this proposed Update?*

Duff & Phelps response. As stated earlier in our response, we are concerned that limiting the concepts of highest and best use and valuation premise to nonfinancial assets, coupled with the absence of unit of account guidance in a number of ASC topics can lead to fair value measurements that are not reflective of how market participants view the assets and liabilities in the context of the business model of the entity. At the same time, by imposing a level of greater disaggregation, the proposed guidance will strain accounting systems and resources, specifically for financial instruments. Thus, the amount of time needed to implement the Fair Value

ED cannot be viewed separately from that of the Financial Instruments ED, which lays out the population of instruments to which fair value accounting would apply. It could take years for systems to be modified to be able to report fair value measurements on the level required by the Fair Value ED.

Other Matters

Restrictions

Recent FASB webcasts and VRG discussions have highlighted the inconsistent application of the guidance in ASC 820-10-55-52, which addresses the manner in which restrictions are considered in the fair value measurement. We believe the intent of such guidance is to require that, to the extent a market participant would pay less for a security that is restricted from sale, such a discount be reflected in the fair value estimate. If there is a contractual restriction on the sale for a period of time relating to the security (e.g. restricted stock issued in connection with a business combination whereby the stock would have been restricted regardless of the identity of the seller), then a hypothetical transfer of the security would include a transfer of the associated restriction.

The newly added paragraph ASC 820-10-35-38A of the Fair Value ED is consistent with this interpretation:

“if a market participant would consider the effect of a restriction on the sale of an asset when estimating the price for the asset, a reporting entity shall adjust the quoted price to reflect the effect of that restriction.”

However, some auditors and regulators (SEC) have interpreted the current guidance as limiting the use of a discount for a restriction to a very narrow set of circumstances (e.g. Rule 144).

The language in the Fair Value ED appears to be more in line with our understanding of the Board’s intent and general business practice, but deviates from the SEC’s narrow interpretation. We believe that the Fair Value ED should clearly articulate both in the text and through examples that any restriction that would be taken into account by market participants should be considered in the fair value measurement.

Fair Value of Contractual Rights to Contingent Consideration

ASC 946 and the application of ASU 2009-12 require that all Investment Company assets be reported at fair value. The lack of decision by the EITF on Issue 09-4 combined with the Board’s views included in paragraphs BC142 through BC146 of the Financial Instruments ED are focused on business combinations. However, these business combination discussions on contingent consideration have been interpreted to apply to Investment Company accounting even though neither the EITF nor the Board seems to have explicitly considered ASC 946 or ASU 2009-12 in their respective discussions.

Because EITF 09-4 and paragraphs BC142 through BC 146 of the Financial Instruments ED focus on business combinations and do not

specifically address the issue of valuing contingent rights from other perspectives, such as that of an Investment Company, the Board's conclusions are confusing and may be misleading. Further, the Financial Instruments ED excludes from its scope contingent consideration arrangements not tied to an observable market or index, which would result in the majority of such arrangements being measured at an amount other than fair value. Thus, most contingent consideration arrangements to be received by a seller would not be measured at fair value which is in direct conflict with ASC 946.

ASU 2009-12 allows Net Asset Value to be used as the estimate of the fair value of an interest in an alternative investment fund, if all underlying investments of the fund are reported at fair value. It is common for a fund to sell an underlying portfolio company investment, retaining the right to future contractual payments (contingent consideration) if certain milestones are met. Consistent with ASC 946 and ASU 2009-12, the Fund manager should report the contractual right at its fair value.

Estimating the value of contractual rights requires judgment and generally requires the use of inputs analogous to those used with Level 3 assets, but is no more difficult than estimating the fair value of other contingent cash flows such as those associated with options and warrants. Further, we believe that paragraphs 820-10-55-4 through 820-10-55-20 of the Fair Value ED provide sufficient guidance to estimate the value of assets such as contractual rights.

We recommend that the Board clearly articulate that Investment Companies should report all assets, including contractual rights to contingent consideration, at fair value. Without these clarifications, practice will diverge and investors in alternative assets may not be able to apply ASU 2009-12 because reported NAV would not include all underlying assets at fair value, as required.

Measurement Uncertainty and Nonfinancial Assets

We understand that under the Fair Value ED, no measurement uncertainty disclosures would be required about a fair value measurement unless that measurement is recorded in the financial statements on a recurring basis.

However, U.S. regulators (SEC) have recently been requiring expanded risk disclosures, inclusive of nonfinancial assets, and specifically related goodwill impairment testing under ASC 350 (e.g. "goodwill at risk" as described in the SEC Corporation Finance Financial Reporting Manual). According to the SEC's guidance, among other disclosures, an entity is to consider disclosing information on the uncertainty associated with the key assumptions, including potential events and/or changes in circumstances,

which could reasonably be expected to negatively affect the key assumptions used in the goodwill impairment analysis.

We are concerned that the measurement uncertainty disclosures proposed in the Fair Value ED might be used as a basis for further augmenting the risk disclosures sought by regulators about nonfinancial assets and liabilities, without fully appreciating the complexity that is inherent in performing a sensitivity analysis in the context of impairment testing, and particularly that of goodwill.

For example, it is not clear what the key assumptions (or unobservable inputs) might be in the fair value measurement of implied goodwill:

- One interpretation could be that the unobservable inputs in determining the goodwill are the enterprise value and the fair values (or other amounts) of the net identifiable assets of the reporting unit, as goodwill constitutes the difference between the enterprise value and the sum of the net identifiable assets.
- Another interpretation would consider inputs or a more granular level, such as the discount rate. Once again, since goodwill is residual calculation, the inputs would potentially span those used in the enterprise valuation and all of its underlying assets and liabilities,

Implementation Guidance

- **Example 1 Case B (Land):** We note that the in-use perspective for the land has changed in 820-10-55-31a; currently ASC 820 focuses on a property/entity-level grouping vs. an individual asset level (land), which is what the proposed amendment seems to infer. This might lead to a different interpretation of the determination of highest and best use in this situation. We recommend that the Board clarify this example.
- **Example 1: Case C (IPR&D)** – the meaning of the example in bullet b. has been changed and is now incorrect.

A defensive asset is “in-use” with the assets it enhances/protects, that is, the asset is used, albeit indirectly, in conjunction with the group of other assets (liabilities) whose value it enhances/protects. The discussion following later in this bullet confirms this interpretation; however, the valuation of the asset is now referred to as “standalone”. The example should be changed to remove

the reference to “standalone” and replace it with the in-use notion described above.

- **Example 1: Case C (IPR&D)** – last bullet c. It is unclear why the measurement of the project is not simply labeled as “standalone”, which in practice would typically lead to a de minimis value.

As currently discussed, the reference to “sell the project by itself” creates confusion, and makes it appear that there is another potential use, in addition to in-use and in-exchange (i.e., in addition to the use of the asset within a group or standalone). We believe the example should be changed to refer to the IPR&D’s standalone use in these circumstances.

- **Example 8: Case A** – we recommend that the example clarify that the nonrecurring fair value measurements may be made during the period rather than only at the end of the period.
- **Example 9: Case A** – we recommend that the example clarify that the 5% adjustment for risk is made for risk that is not already captured in the probability distribution.

Disclosures

- 820-10-50-2 – from an understandability point of view, it would be helpful if each bullet outlining a certain set of disclosure requirements actually specified if it relates to recurring or nonrecurring measurements only, rather than specifying this later in paragraph 820-10-50-2B.
- 820-10-50-3 - it would be helpful if the Fair Value ED clarifies that the disclosure about the use of an asset different from its highest and best use is specifically geared to defensive assets and real estate so that there is less confusion in the implementation of this provision, and the resulting disclosure is in fact meaningful.

Actual v. Hypothetical Transactions

- 820-10-35-6C states that “in the absence of an actual transaction, it is necessary to take into account the characteristics of market participants who would enter into a transaction for the asset or liability”. Even when an actual transaction has taken place, the characteristics of market participants should be taken into account

as the transacting parties may have unique attributes that may be reflected in the pricing.