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9 September 2010

Dear Sir/Madam

Financial Accounting Standards Board Exposure Draft: Proposed Accounting Standards Update, Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (File Reference No. 1830-100)

International Accounting Standards Board Exposure Draft: Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (ED/2010/7)

We appreciate the opportunity to respond to the Proposed Accounting Standards Update, Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs (the "proposed ASU") and the International Accounting Standards Board Exposure Draft: Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (ED/2010/7) (the "ED"). This letter expresses the views of the international network of KPMG member firms.

Because the Boards plan to jointly deliberate their respective proposals, our letter includes our views and comments on both the FASB and the IASB proposals. To the extent the discussion relates to both the proposed ASU and the ED, our comments are directed to the Boards collectively. Comments on the proposed ASU are specifically directed to the FASB.

We believe that convergence between United States generally accepted accounting principles (U.S. GAAP) and International Financial Reporting Standards (IFRSs) is an important objective, and we support the Boards' efforts to develop a single, consistent standard that provides guidance for fair value measurements and disclosures. The consistent application of high-quality, globally-accepted accounting standards related to the measurement and disclosure of fair value should increase comparability of financial information among entities and improve the usefulness of the information available to financial statement users in making decisions related to the allocation of capital. We believe the proposals would achieve convergence, other than for certain non-substantive stylistic differences.



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We commented on differences with U.S. GAAP to the IASB regarding its comprehensive exposure draft on fair value measurement in 2009. We support the effort of the Boards to address comments identified in the IASB's redeliberations and with the experience to date with the FASB's existing guidance.

We agree with the FASB's objectives with respect to the proposed amendments to ASC Topic 820. However, for the reasons summarized below, we believe clarification, and in some instances additional guidance, is necessary to ensure that the proposed amendments will be clearly understood and consistently applied. In addition, we believe certain proposed revisions to existing guidance may result in unintended changes to current practice.

Measuring the Fair Value of Financial Assets and Financial Liabilities When a Reporting Entity Has Offsetting Positions in Market Risks or Counterparty Credit Risk

We support the FASB's intention to provide a mechanism to measure fair value for groups of financial assets and liabilities using a portfolio approach. However, we do not believe the proposed guidance for measuring fair values for groups of assets and liabilities is clearly articulated, which may lead to unintended operational complexity and varying application in practice. Rather than providing prescriptive rules for measuring the fair values of financial assets and liabilities with offsetting market or counterparty and own credit risks, we believe the FASB should provide a principle as to when measuring fair value as a group is appropriate. To illustrate some of the complexities of the proposed, prescriptive, guidance, we noted the following:

- Paragraphs 820-10-35-18I through 35-18N appear to relate only to financial assets and financial liabilities. However, the Basis for Conclusions (BC 28) appears to indicate that the guidance in those paragraphs also applies to non-financial derivative instruments that are accounted for at fair value. We believe that the wording in the former should be revised to be consistent with the guidance in the Basis of Conclusions (BC 28). We believe this guidance should apply not only to financial assets and liabilities measured at fair value in the balance sheet, but also to financial assets and liabilities for which fair value disclosures are made.
- We believe the proposed requirement in paragraph 820-10-35-18J(b) is not necessary. In
 our view, this criterion may present an unnecessary hurdle that may preclude the ability
 to value financial assets and liabilities as a group. Further, the term "information" in the
 criterion is vague and could be interpreted differently across entities.
- We also believe the criterion proposed in paragraph 820-10-35-18J(c) is unnecessary and may result in reporting entities being unable to use this valuation method when there are insignificant changes in how it manages its risks. For example, a literal reading of this criterion could imply that a change from a gap analysis to a value-at-risk analysis would preclude an entity from applying this guidance. We believe entities should not be precluded from applying this guidance when there is no substantive change in how their risks are managed.



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• The proposed ASU provides a distinction between market risk and credit risk, and as written might be read to imply a mutually-exclusive relationship between managing market risk and managing credit risk. Paragraph 820-10-35-18I provides guidance when an entity manages its risk on the basis of its net exposure to either of those risks. We believe the Boards should clarify that the exception in paragraph 820-10-35-181 applies also when an entity manages exposure to both market and credit risks on the basis of its net exposure.

We believe the proposed guidance as drafted may be confusing for entities that have multiple offsetting market risks and use multiple counterparties. The sequencing of how the net market and net counterparty credit valuations are determined may impact the valuation of the groups of financial assets and financial liabilities.

For example, assume an entity uses groups of financial assets and liabilities to manage three distinct market risks: LIBOR interest rates, prime interest rates, and foreign currency. As noted above, an entity might consider that each of these market risks would be required to be managed separately in order for 820-10-35-181 to be applicable. If the entity enters into transactions with five different counterparties to manage each of these three market risks, it may manage counterparty credit risk on a net basis across the same population of instruments (i.e. multiple instruments with a single counterparty may be in each of the three market risk categories). It is unclear whether the entity should segregate its financial assets and liabilities into 15 distinct portfolios (one for each combination of market and credit risk), or if it would value the three net market risk positions and subsequently value the five net counterparty credit risk positions (with some manner of allocation of any resulting credit adjustment to the three market risks).

The composition of the groups of financial assets and liabilities is significant because paragraph 820-10-35-18K would require the entity to value the group using the point within the bid-ask spread that is most representative of fair value. Because of differences in pricing terms and other factors related to the individual financial assets and liabilities in the group, different groupings could produce different bid and ask prices, and thus different midpoints within the bid-ask spread.

We believe the proposed guidance for fair value measurements of groups of financial assets and financial liabilities based on the net counterparty credit risk exposure is contrary to the fair value measurement principles in ASC Topic 820. Paragraph 820-10-35-18L of the proposed ASU states that if the net position is an asset (receivable), then the counterparty's credit risk would be considered in the fair value measurement, and if the net position is a liability (payable) then the entity's own credit risk would be considered in the fair value measurement. This guidance is inconsistent with how market participants value credit risk for derivative financial instruments that have the possibility of being both assets and liabilities at future points in time. In these instances, both the counterparty and the entity's own credit are considered in the determination of a credit valuation adjustment, irrespective of whether the instrument is currently an asset or a liability. Accordingly, we believe the last two sentences of paragraph 820-10-35-18L of the proposed guidance should be removed to be consistent with the fair value principles in ASC Topic 820.



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- Although the proposal would allow for groups of financial assets and liabilities to be valued on the basis of a single net open risk position, paragraph 820-10-35-18N still would require entities to follow existing offsetting requirements for purposes of presentation in the statement of financial position. We believe it will be operationally difficult, and varying practices may result, for entities to develop a fair value estimate for a single net risk position in which the group is the unit of valuation, and then allocate the fair value down to individual financial assets and liabilities when the criteria for offsetting are not met. To assist in the consistent application of this guidance, we recommend adding an example that illustrates the allocation of the fair value estimate for a single net risk position to the individual financial assets and liabilities in the portfolio when the criteria for offsetting are not met. We believe such an example would be useful to understand how to apply the concept of a single unit of valuation when existing accounting guidance requires separate presentation of the components of the group (e.g., the individual financial asset or liability).
- When describing net open risk position concepts, the proposal provides terminology that we believe is not consistent with how the terms are used in practice. Paragraphs 820-10-35-18I and 820-10-35-18L both refer to groups of financial assets and financial liabilities that are in a net asset position as a net long position, while groups in a net liability position are referred to as a net short position. Especially in the context of derivative instruments, we believe many entities would view a forward contract or a future to purchase an asset as a long position, regardless of whether the valuation indicates the contract is in an asset or liability position. We believe the Board should consider revising the proposed guidance to be reflective of how these terms are understood in practice.

Measurement Uncertainty Analysis

We support the Boards' objective to provide financial statement users with more information about the level of uncertainty inherent in a reporting entity's Level 3 fair value measurements, and we agree that disclosures that address interrelationships between unobservable inputs would provide more useful information than a measurement uncertainty analysis that does not consider how changing one unobservable input might affect other unobservable inputs in a fair value measurement.

As currently written we believe the proposed disclosure requirements will be difficult for financial statement preparers to operationalize. On balance we support quantitative disclosures of measurement uncertainty as providing useful information for users; however, given the concerns that some constituents have raised with respect to the costs associated with implementing quantitative disclosures, we encourage the Boards to consider whether the objective of the sensitivity disclosures could alternatively be achieved through disclosures that are qualitative in nature to describe alternative inputs that were considered in the fair value measurement process and the level of sensitivity related to different management judgments of alternative inputs that market participants would likely use in pricing the asset or liability, consistent with the notion of exit price. If the Boards conclude to require quantitative disclosures, we believe revisions to those proposed requirements are necessary.

We believe the Boards should provide an overall objective for the measurement uncertainty analysis. Specifically, we believe the objective of any quantitative disclosure requirement



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should be described as a range of reasonable exit prices that could have resulted from the use of alternative assumptions about inputs to the fair value measurement. Absent this guiding principle, the intention of the Boards as to how the disclosure should be prepared is not clear. For example, the proposed ASU and ED would require entities to consider the interdependency between unobservable inputs when the use of a different input would result in a change in another. However, it is unclear what range of values would be disclosed when a fair value measurement has multiple unobservable inputs that are not interdependent. To illustrate, assume a fair value measurement of \$100 has two unobservable inputs which are not interdependent, and the increase in fair value that would result from a change to each input is \$35 and \$30, respectively. It is not clear whether the entity would disclose the \$65 sum of the changes in inputs, or alternatively if it should disclose the greater of the changes in inputs (\$35). This distinction is significant because the entity may conclude that a resulting value of \$135 when considering other reasonable inputs represents a reasonable exit price; however, if the sum of the changes in inputs is used, the entity may conclude that a resulting value of \$165 using other reasonable inputs does not represent a reasonable exit price. We believe the addition of an overriding principle would help to ensure the measurement uncertainty disclosures do not result in a range of values that would not be representative of a reasonable exit price. In this example, if such a principle existed, the entity would be able to conclude whether the \$165 value is a reasonable exit price and if not then it would not disclose that change. This would also benefit users, as the fair value range would provide more relevant information about the entity's fair value measurements. If the Boards do not intend for the disclosure to provide a reasonable range of exit prices, we still believe the Boards should clarify how entities should determine the ranges to disclose.

In addition, we are concerned about the use of the term "correlation" throughout the proposed ASU and ED. While there are multiple definitions of the term, a common usage is the statistical definition of a simultaneous change in value of two numerically-valued random variables. It is our understanding the Boards intend the term to be interpreted in a more general sense to signify a directional interrelationship; however, we believe in practice the term correlation may be interpreted to require a statistical analysis to determine the degree of the change. Because we do not believe that a reliable calculation of statistical correlation between unobservable inputs is possible, we recommend the Boards choose alternative wording to replace the term correlation throughout the proposed ASU and ED to help avoid possible confusion in practice.

We support the Boards' decision to emphasize the use of judgment in determining significance regarding which changes in fair value resulting from the use of alternative inputs require disclosure. However, we believe that the example in paragraph 820-10-55-80 and paragraph IE4 of the ED illustrates disclosure of fair value changes that likely would not be considered significant in many instances. Specifically, the example table includes disclosure of high-yield debt securities with a fair value of \$90. A fair value increase of \$5 and a fair value decrease of \$3 would result from the use of reasonable alternative inputs. The proposal states that significance would be judged with respect to earnings and total assets or liabilities. Level 3 assets in this table alone total \$373, and we believe most entities would not consider a change of that magnitude to be significant relative to the asset balance. Accordingly, the threshold for such a change to be disclosed may not have been met. We believe some entities may interpret this example to require disclosure of relatively insignificant changes in fair value. We suggest that the Boards revise the example disclosures to illustrate disclosure of fair value changes whose significance is more evident. In addition, we believe that there is a deficiency in the illustrative example presented relative to the required disclosures because the example does not include any



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disclosure of how the entity calculated the effects as would be required by paragraph 820-10-50-2(f) and paragraph 2(a) of the ED.

The disclosure is required by class of asset. Class is not defined in the ED. We note that existing U.S. GAAP (ASC paragraph 820-10-65-7) contains guidance on how classes are to be determined in the context of fair value measurements and disclosures. We recommend that the Boards agree to a common definition of class for purposes of fair value measurements and disclosures and include that definition in both U.S. GAAP and IFRS.

Application of ASC Topic 820 Fair Value Measurement Principles to Disclosures of Items not Measured at Fair Value

We support the FASB's proposal to require all disclosures about fair values to be prepared using the fair value measurement principles in ASC Topic 820. However, we note that for some entities, in particular those entities holding loans receivable, the proposed change is unclear. Specifically, ASC paragraph 825-10-55-3 permits reporting entities to estimate the fair value of loans receivable using an entry price notion, in which future cash flows are discounted using the current rates at which similar loans would be made to borrowers with similar credit risks. We understand that the guidance in this example is used widely in practice for disclosure of fair values of loan receivables that are not measured at fair value in the statement of financial position. The proposed ASU would not amend paragraph 825-10-55-3, and it is unclear as to whether the FASB intended to preserve this method of estimating fair values of loans receivable.

If the proposed guidance will affect how loans receivable are reported under 825-10-55-3, then we believe the cost and effort that would result from requiring disclosures of the fair value of loan receivables determined using the principles of ASC Topic 820 may warrant a delayed effective date. We note that in the Basis for Conclusions of the FASB's Proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities, an important reason for the deferred effective date for measuring loans at fair value is to provide entities with sufficient time to develop and implement information systems and financial reporting processes. We believe similar operational concerns exist with respect to estimating fair values of loans receivable for disclosure purposes. Accordingly, we recommend that the FASB carefully consider input from financial statement preparers on this proposed ASU about this possible change to 825-10-55-3.

Principal Market for an Asset or Liability

Paragraph 820-10-35-6A of the proposed ASU states the principal market for an asset or liability is determined from the perspective of the reporting entity, and therefore different entities can have different principal markets for the same asset or liability. The concept that the principal market is determined from the perspective of the entity that holds the asset or liability is reinforced by paragraph 820-10-35-5A, which states that in absence of evidence to the contrary, the market in which the entity would enter normally into a transaction is presumed to be the principal market.

However, paragraph BC50 of the Basis for Conclusions says "The Board decided to clarify that the principal market should be determined on the basis of the market for the asset or the liability with the greatest volume and level of activity for the asset or liability." This statement is



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contradictory to the guidance in paragraph 820-10-35-5A because the market for an asset or liability with the greatest volume and level of activity for that asset or liability is often different than the market in which an entity normally transacts.

As written, the Basis for Conclusions could be read to require an entity to treat the market with the greatest volume and level of activity for the asset and liability as the reference market whenever it can access that market, even if another market in which the entity usually transacts, already exists. For example, assume an entity in Iowa owns a fungible chemical which is priced in active markets in Iowa at \$1,100 per ton. These markets are where the entity normally transacts. The chemical is also bought and sold in Singapore, at volumes significantly greater than anywhere else in the world. Through a broker, the entity could access the Singapore market. The price in Singapore for the chemical is \$1,200 per ton, however it would cost \$300 per ton of direct costs to transport the chemical from Iowa to Singapore. The discussion in the Basis for Conclusions appears to indicate that the entity would measure the fair value of the chemical inventory at \$900 per ton, because it could be interpreted that Singapore is the entity's principal market based on volume and level of activity.

The Basis for Conclusions appears to be in contrast to the guidance in paragraph 820-10-35-5A, which indicates that in the absence of evidence to the contrary, the market in which the reporting entity would normally enter into a transaction to sell the inventory is presumed to be the principal market, or Iowa in this example. Based on our experience, current practice would value the inventory using the price in Iowa, or \$1,100 per ton.

We believe that basing fair value measurements on the price at which a transaction would take place between participants in the market in which the reporting entity would usually transact generally provides the most decision-useful information and generally is more relevant than the price in another market in which the entity would not transact, even if that market has a higher volume and level of activity; additionally, requiring entities to use prices from markets in which they would not transact would likely increase the costs to preparers of financial statements. Accordingly, we recommend the Board remove the discussion from the Basis for Conclusions and retain the existing U.S. GAAP definition of principal market in the Master Glossary.

Highest and Best Use

The proposed ASU modifies the guidance in ASC paragraph 820-10-35-10A to say that a use of an asset that legally is permissible takes into account any legal restrictions, and specifically refers to zoning regulations applicable to a particular property. This wording could be interpreted to indicate that a use that is not consistent with current zoning should not be considered in the fair value measurement. Under ASC Topic 820, we believe that it would not be appropriate for an entity to disregard a potential use of an asset that is not consistent with current zoning if a market participant would consider a potential change in zoning when pricing the asset.

Application to Liabilities

When estimating the fair value of a liability using a present value technique, paragraph 820-10-35-16I of the proposed ASU would require entities to consider whether the contractual rate of return on a *financial liability* includes the compensation that market participants would require for taking on the obligation. We believe the wording used in the ED may cause confusion and may lead financial statement preparers to include elements in the discount rate other than the

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current applicable interest rate (which for a basic debt instrument generally comprises risk free, credit and liquidity risks) required by market participants for fair value measurements of a financial liability.

Measuring the Fair Value When the Volume and Level of Activity for an Asset or Liability Have Decreased Significantly

We believe that the proposed changes to paragraph 820-10-35-54D could be significant because they change the presumption under U.S. GAAP that a transaction in a market with decreased volume or levels of activity is not determinative of fair value. We are unclear whether the Boards intended to change this presumption, but practice changes may result if changes are permitted or required. Existing U.S. GAAP guidance states "transactions or quoted prices may not be determinative of fair value (for example, there may be increased instances of transactions that are not orderly). Further analysis of the transactions or quoted prices and a significant adjustment to the transactions or quoted prices may be necessary to estimate fair value in accordance with this Subtopic." This wording implies a presumption that a price or quote from a market in which volumes or levels of activity have decreased significantly is not determinative of fair value unless there is evidence to the contrary.

The proposal would replace the above language, and instead say "A decrease in the volume or level of activity on its own does not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if a reporting entity determines that a transaction or quoted price is not determinative of fair value (for example, there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary." This shifts the presumption under U.S. GAAP to imply transactions or prices from less active markets are determinative of fair value unless evidence exists to the contrary. We recommend replacing the words "does not indicate" in the proposed language with the words "may not indicate".

In addition to the comments above, the Appendix to this letter provides certain drafting recommendations that the Boards may wish to consider that could enhance clarity on the application of the proposed ASU and the ED.

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 or Robert Hilbert at (212) 909-5303 with KPMG LLP in New York or Mary Tokar or Jim Calvert with the KPMG International Standards Group in London at +44 (0)20 7694 8871.

Yours faithfully

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Appendix

Proposed Accounting Standards Update, Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs

(File Reference No. 1830-100)

International Accounting Standards Board Exposure Draft: Measurement Uncertainty Analysis Disclosure for Fair Value Measurements (ED/2010/7)

As discussed in our attached letter, we support the Boards' efforts to achieve convergence in the guidance related to fair value measurements and disclosures and we support many of the proposed revisions to ASC Topic 820. However, we believe certain revisions to the proposed ASU are necessary to ensure that the proposed revisions are interpreted and applied consistently. The Appendix to this letter provides certain drafting recommendations that the Boards may wish to consider that we believe would enhance clarity on the application of the proposed ASU.

- Paragraphs 820-10-35-2B and 820-10-35-2E contain unnecessary duplicative references to the implementation guidance illustrating the effect of a restriction on fair value.
- Paragraph 820-10-35-5A provides the presumption that the market in which an entity normally transacts is its principal, or most advantageous, market. We believe if there is a market in which an entity normally transacts, and is therefore considered the principal market, then the presumption about the most advantageous market is unnecessary. This is illustrated by paragraph 820-10-35-6 which says if there is a principal market for the asset or liability, then the fair value measurement uses the price from that market, even if the price in a different market is potentially more advantageous.
- Paragraph 820-10-35-10D (a)(2) states that "Complementary liabilities include liabilities
 that fund working capital, but do not include liabilities used to fund assets other than those
 within the group." We are unclear as to the meaning of that statement and suggest
 clarification to make the intention of the revision more apparent.
- ASC paragraph 820-10-35-18H in existing U.S. GAAP contains a reference to the Securities
 and Exchange Commission Accounting Series Release No. 118, Accounting for Investment
 Securities by Registered Investment Companies. The proposed ASU would remove that
 reference, and we are unclear as to why this reference was determined to be no longer
 necessary. We believe there is useful guidance within the SEC literature, and therefore
 suggest that the FASB discuss that guidance with the IASB and consider incorporating any
 relevant guidance within the converged standards.
- The proposed changes to paragraph 820-10-35-35C would remove the explicit requirement to calibrate models to the transaction price in all circumstances. We believe the change might result inappropriately in calibration being performed only for measurements involving unobservable inputs, which we believe is inconsistent with current practice. We are unclear whether or why the Boards proposed this amendment.



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- Beginning in paragraph 820-10-35-36B, the proposed ASU provides a clearer differentiation between adjustments that constitute a blockage factor, which is not permitted for any observable price, and adjustments that represent control premiums or noncontrolling interest discounts that would be permitted. We support these clarifications and believe the proposal is appropriate in this regard. However, additional guidance should be added to the final standard to enhance the usefulness of the clarified guidance. The Basis for Conclusions elaborates on the distinction by stating that the decision to incur a blockage discount is an entity-specific decision and is therefore not relevant to a fair value measurement, whereas other premiums or discounts that would be considered by market participants would be considered in a fair value measurement. The discussion in the Basis for Conclusions articulates a general principle that is not apparent in the proposed codification updates, and as such we believe this general principle should be included at the beginning of this section in the codification.
- We are unclear as to why the guidance for assessing significance for purposes of
 determining which transfers between levels of the fair value hierarchy would be disclosed
 was removed from paragraphs 820-10-50-2(bb) and 820-10-50-2(c)(3). The Boards should
 consider retaining that guidance to provide a consistent framework for evaluation of
 significance.
- Paragraph 820-10-50-6A provides specific disclosure requirements for investments in entities that calculate net asset value per share (or its equivalent), and these disclosures are required for each class of investment. Existing U.S. GAAP provides specific guidance on how classes should be determined; specifically, classes are to be determined based on the nature and risks of the investments. The proposed ASU would remove that guidance, and instead entities would be required to provide the disclosures for "each class of investment." It is unclear whether the FASB intends for a class to represent investments in similar types of entities (e.g., investments in hedge funds, investments in private equities), or if those broader types would need to be further disaggregated based on the underlying risks of the investments (e.g., hedge funds investing in mortgages, hedge funds investing in commodities). We suggest the FASB include clarifying language to more clearly state what is to be disclosed.
- In paragraph BC 58 the Boards clearly state that the purpose of the measurement uncertainty disclosures is to provide users with information about the measurement uncertainty inherent with Level 3 fair value measurements, and that the disclosure is not forward-looking (e.g., not intended to predict how a fair value measurement would change in the future because of changes in economic conditions). We suggest the Boards bring a similar statement into the codification update to clarify that the disclosure is not intended to present forward-looking information.
- The example in paragraph 820-10-55-59 illustrates a bond with a payout linked to equity prices. The discussion that follows says that the fair value is estimated considering only expected cash flows, risk-free interest rates and credit spreads. However, a market participant likely would also demand compensation (a risk premium) for bearing the risk of changes in the S&P 500 index, and accordingly we suggest that a discussion of the risk premium be added to the example.



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Paragraph 820-10-55-48 contains an example that we believe is inconsistent with how retail
swap counterparties would measure fair value of an interest rate swap. The example
indicates that the transaction price of zero would represent the fair value of the swap at
initial recognition. We do not believe the example is consistent with market practice for
valuing swaps that are executed at zero transaction price. Accordingly, we suggest the
FASB use this opportunity to amend this example to indicate the swap's fair value at initial
recognition may not equal its transaction price.