



American Institute of CPAs  
220 Leigh Farm Road  
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September 17, 2010

Russell G. Golden, CPA  
Technical Director  
FASB  
401 Merritt 7  
PO Box 5116  
Norwalk, CT 06856-5116

**Re: June 29, 2010 Exposure Draft of a Proposed Accounting Standards Update (ASU), *Fair Value Measurements and Disclosures (Topic 820): Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* [File Reference No. 1830-100]**

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the ED and is providing the following comments for your consideration.

### **GENERAL COMMENTS**

TIC's comments on this ED are limited to two of the proposed requirements for additional disclosures:

- The measurement uncertainty analysis disclosure for recurring fair value measurements categorized within Level 3 of the fair value hierarchy (the "sensitivity disclosure"); and
- The disclosure of a reporting entity's decision to use an asset in a way that differs from its highest and best use (when that asset is recognized at fair value in the statement of financial position on the basis of its highest and best use).

As stated in paragraph BC57 of the ED, the proposed sensitivity disclosure is similar to the one proposed in the August 28, 2009 FASB ED, *Improving Disclosures about Fair Value Measurements*. TIC wrote a comment letter to the Board dated October 12, 2009 opposing the disclosure because it would be irrelevant to users, burdensome to preparers and, in certain circumstances, non-operational for preparers to implement. Similar concerns

were also expressed by the Private Company Financial Reporting Committee in its letter, also dated October 12, 2009. TIC had hoped that the basis for conclusions of this ED would have addressed the Board’s consideration of these comments in its deliberations on what is now referred to as the “measurement uncertainty disclosure.”

TIC continues to oppose this disclosure for private entities and recommends that the Board engage in an outreach effort with private company financial statement users before finalizing the ED. TIC believes this effort would demonstrate that such users do not need and would not use such disclosures, thereby providing the necessary rationale to consider exempting private entities from the disclosure.

TIC also opposes the disclosure of an entity’s reasons for using an asset in a manner that differs from its highest and best use and also recommends an outreach effort to users. In addition, for those entities for which the disclosure is applicable, TIC has proposed some recommendations for clarifying the requirement.

The ED does not state whether the disclosures are applicable for both annual and interim periods. TIC believes this omission may be inadvertent. However, if the Board requires private entities to provide the above disclosures, which TIC would oppose, the requirement should apply to year-end financial statements only and not for interim periods.

## **SPECIFIC COMMENTS**

### **Sensitivity Disclosures for Level 3 Fair Value Measurements**

Private entities should be exempt from this proposed disclosure, since it completely fails the user relevance and cost/benefit tests. The disclosure is not decision-useful to the primary users of these statements and would impose excessive cost burdens on preparers. TIC reached this conclusion based on its understanding of the user’s perspective about fair value measurement disclosures, the costs that preparers would incur in obtaining the information for the disclosures and the implementation difficulties that some preparers would face in attempting to obtain the required information for the disclosure.

#### The User Perspective

A requirement to provide recurring sensitivity disclosures on recognized financial assets and liabilities measured at fair value would be irrelevant to the investing and lending decisions of private sector users and would be disregarded.

Lenders will not benefit from additional information about the sensitivity of fair value measurements to reasonably possible alternative inputs, as, for the most part, lenders



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focus on the borrower's ability to repay its debt and the value of the asset(s) that collateralize the debt. Disclosures that do not address these objectives are ignored because they do not inform the lending decision.

One reason why such disclosures have no relevance to the lending decision is that the lender may be a counterparty in a transaction involving the borrower. Lenders often require that their private sector customers invest in certain financial instruments as a condition for granting a loan. For example, many lending institutions require their borrowers to enter into interest rate swaps in connection with providing variable rate long-term financing. The fixed rate on the swap offsets the variable rate of the debt which enables the private entity to have predictable cash flows over the term of the loan. In effect, the lenders are requiring their debtors to manage their exposure to interest rate variability. The lender is often the counterparty to the swap and is usually the entity calculating the value of the swap. Many of the swaps involve Level 3 inputs and would therefore be subject to the proposed disclosure. For these transactions, the lender (not the borrower) has exclusive access to the relevant pricing models, which represent the unobservable inputs to the fair value calculation. If the financial statement user already has access to more information than the borrower, there is no point in requiring the borrower to provide disclosure.

TIC has also observed that certain nonfinancial assets recognized at fair value on the balance sheet are disregarded by lenders as they make their lending decisions. Impaired goodwill is one such example. Lenders subtract the value of goodwill from the borrower's assets and therefore disregard its value entirely. The measurement method used and the inherent uncertainties of the measurement are irrelevant.

To the extent that financial statement users read the sensitivity disclosures for other assets and liabilities that are carried at fair value on the balance sheet, TIC believes the substance of the disclosure is too complex for users to understand and apply. They will not know what to do with a measurement uncertainty analysis that discusses the interdependencies among multiple unobservable inputs. Understanding the effect of one key variable can be difficult enough, but fair value measurements can be based on five or six different variables with complex interrelationships that only specialists will understand. Private entity users cannot be expected to grasp these concepts based on footnote disclosure. TIC is also concerned that lack of understanding could lead to misperception. Paragraph BC63 indicates that "the disclosure is not meant to provide users of financial statements with information for second guessing a reporting entity's fair value measurements." However, TIC believes that, without proper understanding, second guessing could result.

The needs of private sector users and their perception of fair value measurements differ significantly from those of professional analysts who are among the primary users of public entity financial statements. TIC believes this key difference should be taken into consideration as the FASB deliberates whether the final standard should include



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differences for private entities. TIC strongly encourages the Board to engage in outreach efforts with users of private entity financial statements to confirm TIC's view of the user perspective.

### The Preparer Perspective

The proposed disclosure would create a significant burden for many private sector preparers in terms of cost, time and effort.

The stated scope of the ED includes a wide array of private entities, including not-for-profit organizations, employee benefit plans, health care entities, real estate developers and many other commercial entities. The scope also involves many types of financial and nonfinancial assets and liabilities. Some examples include previously incurred mark-downs to fair value for nonfinancial assets such as goodwill, intangible assets and fixed assets, certain nonfinancial liabilities (e.g., asset retirement obligations), assets arising from split interest agreements (e.g., beneficial interests in perpetual trusts and charitable remainder trusts) of not-for-profit organizations, as well as entities with traditional financial assets and financial liabilities valued at fair value. Some private entities will have multiple assets and liabilities that would be subject to the disclosure.

The scope of fair value measures affected by the proposal coupled with the complexity of the disclosure cannot be sustained by private entities in any cost effective manner on a recurring basis. Most private entities do not have the in-house expertise to identify all of the unobservable inputs that could have reasonably been used in the circumstances and then analyze which combination of them could have resulted in a significantly higher or lower fair value measurement, especially if correlation factors need to be considered. Preparers would most likely need to outsource the preparation of these disclosures to a specialist, or, if they are already using a specialist to calculate recurring fair values, would have to incur more cost to have the additional disclosures prepared. This also increases the entity's audit costs, since the auditor would have additional audit procedures to perform, which could involve hiring an independent specialist to audit the work of the client's specialist.

In some cases, the data necessary to develop the proposed disclosure may not be available. As discussed above, many private entities enter into interest rate swap contracts as a condition of the loan. Many nonpublic entities use external pricing services recommended by their lenders to determine fair value. One such service with which TIC members are familiar uses a proprietary process to perform its valuations. The borrower only receives a mark-to-market report from the counterparty and is not given access to the pricing model. Without access to pricing models, it would be impossible to provide sensitivity disclosures. Therefore, in the near term, the information required by the disclosure will not be available to preparers. This obstacle makes the disclosure nonoperational for many entities that have interest rate swaps.



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TIC believes these obstacles will give preparers another reason to ask lenders for additional GAAP exceptions in lieu of incurring costs to develop a disclosure that lenders will not use. TIC believes this already occurs much too often in the private sector and is concerned that it erodes the value of GAAP.

TIC also analyzed the sample disclosure in FASB *Accounting Standards Codification* (ASC) paragraph 820-10-55-80. The tabular presentation on page 127 is very quantitative in nature and implies a level of precision that does not exist. The Board is recommending (ASC paragraph 820-10-55-81) that preparers provide additional qualitative disclosure that, for example, would “describe the relative subjectivity and limitations of the unobservable inputs and the range of unobservable inputs used.” This additional explanatory material is not illustrated in the example, but TIC believes it will do nothing more than reinforce what financial statement users already know—that fair value measures are based on inherently uncertain assumptions, the selection of which is a matter of professional judgment in the circumstances.

The table is also confusing, since users will not understand whether the effect of the increase/decrease columns should be netted or evaluated in isolation. The disclosure example should provide a better explanation of the illustrative figures. TIC believes the new disclosure could be misleading, if not clarified, and, for users of private sector financial statements, will not achieve the Board’s goal of “improving the understandability of the fair value measurement guidance currently in U.S. GAAP” (paragraph BC76).

### **Disclosure of an Entity’s Reasons for Using a Nonfinancial Asset in a Manner That Differs from its Highest and Best Use**

Paragraph BC69 states that this proposed disclosure requirement “would provide useful information for users of financial statements.” However, the primary users of the financial statements of private entities are not asking for additional disclosures to help them gauge management’s stewardship function. Lenders already have all the information they need through their internal processes, lending models and direct interaction with management.

TIC also believes that such disclosure could be misleading because financial statement users within TIC’s constituency do not have a thorough understanding of the underlying principles of highest and best use. Users may not understand that highest and best use is determined from the market participant’s perspective without regard for the entity’s strategic plans and without regard for certain critical cost factors. As a result, users are not in a position to evaluate the implications of a current use that differs from the highest and best use. To require disclosure of a current use that differs from the highest and best use may erroneously imply that management is foregoing actual gains that, in reality, may never have the potential to be realized.



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TIC recommends that such users should be consulted by the Board before proceeding with this disclosure requirement.

For the benefit of all entities that will be subject to this disclosure, TIC recommends that ASC paragraph 820-10-50-2E be revised to clarify that the disclosure applies only to nonfinancial assets (such as certain fixed assets and intangibles) that are recognized at fair value in the statement of financial position (perhaps as a result of a business combination or an impairment markdown). ASC paragraph 820-10-50-2E, as currently written, implies that such disclosure would apply to any asset irrespective of its measurement basis. Clarification of this paragraph is needed to be consistent with the text in paragraph BC69 and ASC paragraph 820-10-35-10A.

### **Periods for Which the Disclosures Apply**

The summary in each ED normally identifies effective dates and the period(s) for which disclosures are required. However, this ED (page 6) states only that the proposed amendments would be effective as of the beginning of the period of adoption without any indication of the periods (annual and/or interim) for which the disclosures will be required on an ongoing basis. In addition, ASC paragraph 820-10-50-2 (page 70) was revised to cross out the existing requirement for interim and annual period disclosure. This change was not explained, and new language as to when the disclosures should be made was not provided. TIC believes this may be an oversight and requests that the Board clarify whether the disclosures will be required for interim, as well as annual, periods. As stated above, TIC opposes this disclosure for private entities. However, if the Board decides to adopt it for all entities, TIC recommends a concession to private entities to provide disclosure on an annual basis only.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

A handwritten signature in black ink that reads 'Philip J. Santarelli'.

Philip J. Santarelli, Chair  
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees