Comment: measurement uncertainty in Level 1 and Level 2

Dear Technical Director:

Question 1 asks whether the proposed amendments improve the understandability of fair value measurement guidance and what are unintended consequences of the proposed amendments. Question 7 asks whether those commenting think the proposed measurement uncertainty analysis of Level 3 inputs is appropriate and Question 8 asks for alternatives.

I think that limiting measurement uncertainty analysis to Level 3 and the narrow scope of the analysis are not appropriate. Market risk inherent in market risk sensitive instruments should be disclosed in the financial statement footnotes. Given the financial crises and market crashes that started in 2008, omission of measurement uncertainty inherent in Level 1 and Level 2 could call into question whether the financial statements and disclosures “faithfully represent fair value”. The analysis provided should meet the intent of the Sarbanes-Oxley Act that a principles-based accounting system should withstand economic analysis. (A, D)

The exposure draft, Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS, states in part as follows:

“BC58. The Board concluded that the objective of a measurement uncertainty analysis disclosure is to 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 at the measurement date.”

Securities Exchange Commission Financial Reporting Release No. 48, 1997, requires quantitative and qualitative information about market risk inherent in market risk sensitive instruments to be disclosed outside the financial statements and related footnotes. (BC59, B)

An example of the effect of the futures market on price determination is indicated in the following conclusion to a working paper by Joshua V. Rosenberg, PH. D., Economist, et al.

“Despite the dominance of the foreign exchange spot market in terms of total trading volume, we find that the foreign exchange futures market also plays an important role in price formation in 1996. This conclusion is supported by analyses of the information content of order flow, short-term price dynamics, and long-term price dynamics. One possible reason for the key role of the futures market in price determination is its much higher level of transparency compared to direct interdealer spot trading.” (C)

References and other comments are provided in the appendix for your consideration.
1830-100
Comment Letter No. 41

Financial Accounting Standards Board
September 7, 2010
Technical Director, director@fasb.org File Reference No. 1830-100

cc: Joshua V. Rosenberg, PH. D., Economist, V.P., NY FRB, joshua.roenberg@ny.frb.org

APPENDIX

Other comments:

Question 2 addresses the “highest and best use and valuation premise” when measuring the fair value of nonfinancial assets.

My web search indicates that the “highest and best use and valuation premise” is a concept from real estate appraisal and that the relevant principle from economics may be opportunity cost or alternative foregone. If most reporting entities applied the “highest and best use and valuation premise”, would resulting values in total be overstated and unfair in the aggregate?

I think that if doctorate-level economists from various respected institutions were to review the development of common accounting standards, assuring consistency with the postulates of economic theory before issuance would be more likely. I think that evidence of timely economic analysis and review should be made available to the public.

References from the Exposure Draft:

Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS provides the following paragraphs that are: “Copyright © 2010 by Financial Accounting Foundation. All rights reserved. Used by permission.”

“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.

“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.

“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?

"Question 8: 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.

"BC58. The Board concluded that the objective of a measurement uncertainty analysis disclosure is to 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 at the measurement date. The proposed disclosure is not intended to reflect remote (including worst-case) scenarios and it is not forward looking (that is, the analysis in the proposed disclosure is not meant to predict how a fair value measurement would change in the future because of changes in future economic conditions).

"BC59. The Board believes the objective of the proposed measurement uncertainty analysis disclosure is different from the objectives of other disclosures that a reporting entity may be required to make, such as SEC Financial Reporting Release No. 48, Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments, and Derivative Commodity Instruments. For example, the disclosure in the Financial Reporting Release provides information about a reporting entity’s exposure to market risks, whereas the measurement uncertainty analysis disclosure would provide information about the measurement uncertainty related to those fair value measurements with the greatest level of subjectivity (that is, fair value measurements categorized within Level 3 of the fair value hierarchy)."

Other references:

A. “October 2008 Stock Market Crash ... from October 1st through October 10th... the DJIA would drop a total of 2,399.47 points or 22.11%. ... investors were reacting to the worrisome credit market news that started back in March 2008.”
Financial Accounting Standards Board
Technical Director, director@fasb.org


“This paper presents preliminary findings and is being distributed to economists and other interested readers solely to stimulate discussion and elicit comments. The views expressed in the paper are those of the authors and are not necessarily reflective of views at the Federal Reserve Bank of New York or the Federal Reserve System. Any errors or omissions are the responsibility of the authors.” Title Page.

Sec. 108. Accounting Standards.
(d) Study and report on adopting principles-based accounting —
(iv) a thorough economic analysis of the implementation of a principles-based system.
SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 210, 228, 229, 239, 240, and 249

[Release Nos. 33-7386; 34-38223; IC-22407; FR-48; International Series No. 1047; File No. S7-35-95].

RIN 3235-AG42
RIN 3235-AG77

DISCLOSURE OF ACCOUNTING POLICIES FOR DERIVATIVE FINANCIAL INSTRUMENTS AND DERIVATIVE COMMODITY INSTRUMENTS AND DISCLOSURE OF QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT MARKET RISK INHERENT IN DERIVATIVE FINANCIAL INSTRUMENTS, OTHER FINANCIAL INSTRUMENTS, AND DERIVATIVE COMMODITY INSTRUMENTS

AGENCY: Securities and Exchange Commission

ACTION: Final rules

SUMMARY: The Securities and Exchange Commission ("Commission" or "SEC") is amending rules and forms for domestic and foreign issuers to clarify and expand existing disclosure requirements for derivative financial instruments, other financial instruments, and derivative commodity instruments, as defined (collectively "market risk sensitive instruments"). The amendments require enhanced disclosure of accounting policies for derivative financial instruments and derivative commodity instruments (collectively "derivatives") in the footnotes to the financial statements. In addition, the amendments expand existing disclosure requirements to include quantitative and qualitative information about market risk inherent in market risk sensitive instruments. The required quantitative and qualitative information should be disclosed outside the financial statements and related notes thereto. In addition, the quantitative and qualitative information will be provided safe harbor protection under a new Commission rule. Finally, this release reminds registrants that any disclosures about financial instruments,
commodity positions, firm commitments, and anticipated transactions ("reported items"), should include disclosures about derivatives that directly or indirectly affect such reported items, to the extent such information is material and necessary to prevent the disclosures about the reported items from being misleading. In the aggregate, these amendments are designed to provide additional information about market risk sensitive instruments, which investors can use to better understand and evaluate the market risk exposures of a registrant.

DATES: Effective Date: [Insert date 60 days after Federal Register publication].

Compliance Dates: ¹ 210.4-08(n) of Regulation S-X and the amendment to Item 310 of Regulation S-B shall be effective, and disclosures under that rule shall be required, for filings with the Commission that include financial statements for fiscal periods ending after June 15, 1997. For bank and thrift registrants, as defined, and non-bank and non-thrift registrants with market capitalizations on January 28, 1997 in excess of $2.5 billion, Item 305 of Regulation S-K and Item 9A of Form 20-F shall be effective, and disclosures under those items shall be required, for filings with the Commission that include annual financial statements for fiscal years ending after June 15, 1997. For non-bank and non-thrift registrants with market capitalizations on January 28, 1997 of $2.5 billion or less, Item

http://www.sec.gov/rules/final/33-7386.txt