September 14, 2004

Ms. Suzanne Bielstein
Director of Major Projects
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

File Reference No. 3459

Dear Ms. Bielstein:

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants is pleased to offer comments on the FASB’s June 23, 2004, exposure draft (ED) of a proposed Statement of Financial Accounting Standards, Fair Value Measurements.

Overall Comments

AcSEC supports the Board’s objective of providing guidance on how to measure fair value that would apply broadly to items measured at fair value under other authoritative pronouncements. AcSEC generally supports the ED, as we believe it helps constituents better understand the concept of fair value as required under other pronouncements and helps bring consistency and uniformity to the various references to fair value in the accounting literature.

ISSUE 13
Reliability of fair value estimates; coordination with audit standard setters

AcSEC has concerns about the reliability and verifiability of fair values in certain situations, particularly those determined using Level 3 estimates involving entity-specific estimates. Examples of those situations include valuations based on an entity’s intent for the future disposition of an asset being valued, and management’s internal estimates of scenario probabilities in an expected cash flow calculation. Under FASB Concepts Statement No. 2, Qualitative Characteristics of Accounting Information, verifiability is a key component of reliability, a primary decision-specific quality of accounting information. AcSEC encourages the Board to consider AcSEC’s concerns about reliability and verifiability and, consequently, auditability of fair value measurements in the Board’s future deliberations on the use of fair value in financial reporting.

\[\text{For your convenience, we have referenced our comments to the issues identified in the Notice for Recipients in the ED.}\]
In addition, AcSEC believes that there should be a “meeting of the minds” between the FASB and audit standard setters. In his April 29, 2004 speech at the Baruch College Third Annual Financial Reporting Conference, the PCAOB’s Chief Auditor expressed views on verifiability of information used in determining fair value that appear to have particular implications for valuations performed using Level 3 estimates:

When fair value cannot be measured by reference to matters that are directly observable, and if the measure represents little more than the measurer’s state of mind, neither the measurement nor the measurement method are verifiable. In those circumstances, the independent auditor has a scope limitation and should not express an unqualified opinion on the financial statements that are materially affected by such a measurement. However, there is nothing specific or definitive in accounting or auditing standards to direct this result. Resolving this verifiability issue will require the attention and cooperative efforts of accounting and auditing standard setters and regulators. In the meantime, the independent auditor should exercise due care, including the use of heightened professional skepticism, to ensure that measurer bias has not materially affected a fair value measurement based on valuation techniques.

With the objective of having the interface between accounting and auditing standards be as seamless as possible, AcSEC recommends that the FASB consider providing guidance as to types and sources of “verifiable” information with respect to what paragraph 24 of the ED, which discusses Level 3 estimates, describes as “significant entity inputs derived from an entity’s own internal estimates and assumptions.”

The PCAOB’s Chief Auditor also made the following remark in his December 12, 2003 speech at the AICPA National Conference on SEC Developments:

If management intent is relevant to the determination of fair value, the auditor should obtain better evidence than simply management’s representations.

AcSEC views that remark as being particularly relevant to the concept of a valuation premise discussed in paragraph 13 of the ED. That concept is illustrated in paragraph B7(a) of the ED, which discusses a business combination in which the fair value of a machine is to be determined and states that the machine “will continue to be used in income-producing activities of the combined entity.” The valuation premise, as illustrated by the statement in paragraph B7(a), reflects management’s intent. However, the ED does not discuss how management might support its intent.

In light of the implications of the above statements by the PCAOB’s Chief Auditor and the application of the proposed Statement, AcSEC recommends that the FASB, if it has not already done so, actively solicit comments on the ED from both the PCAOB and the AICPA’s Auditing Standards Board. The FASB also may wish to consider coordinating the effective date of the Statement with the effective date of any guidance issued by audit standard setters on the sources of competent evidential matter to support Level 3 estimates of fair value.

ISSUE 6, 13
Coordination with SEC
AcSEC recommends that the FASB coordinate the issuance of a final Statement with the issuance of any resulting modifications of SEC regulations. Such modifications would likely be necessary to ensure consistency. For example, application of the “most advantageous market” concept, as discussed in paragraph 16 of the ED in the context of Level 1 estimates, is not necessarily consistent with the requirements of ASR No. 118, Accounting for Investment Securities by Registered Investment Companies, Section 404.03.b.ii, “Securities Listed or Traded on a National Securities Exchange.” Under those requirements, for example, “In the case of securities listed on more than one national securities exchange the last quoted sale, up to the time of valuation, on the exchange on which the security is principally traded should be used or, if there were no sales on that exchange on the valuation date, the last quoted sale, up to the time of valuation, on the other exchanges should be used.” [Emphasis added]

ISSUE 9
Multiple valuation techniques
AcSEC believes that the proposed guidance regarding the use of multiple valuation techniques should be reconsidered. Valuation standards promulgated by widely recognized professional valuation organizations allow for the possibility that consideration of the three approaches may result in the conclusion to omit one or more approaches due to lack of relevance, lack of readily available information, or other supportable reasons. Those standards also require justification of how various approaches and methods are reconciled in reaching a conclusion of value. The guidance in a final Statement should, therefore, more clearly indicate that the market, income, or cost approaches to determining value are not always relevant and in different situations could result in different estimates of value that are of differing levels of importance. Further, a final Statement should indicate that a significant part of any valuation involves the identification of the approaches and methods that should be applied and how the results of the different approaches and methods should be assessed in determining a final estimate of fair value. In sum, AcSEC believes a final Statement should include a more robust discussion of the consideration and application of the market, income, and cost approaches to determining fair value, and that discussion should incorporate a reconciliation of the three approaches to the concepts of Level 1, 2, and 3 estimates. The result would be a Statement that is easier to understand and more familiar to valuation professionals.

Consider, for example, the case of a Level 1 estimate. In this case a particular indicator of value (the quoted market price) may be so superior that the other approaches (income and cost) would not be considered to provide any credible evidence of a different fair value. In such a case, the valuer would conclude that only the market approach should be applied. AcSEC believes the Statement should not suggest that the lesser methods could be applied in these circumstances. Additionally, AcSEC recommends that the Valuation Techniques and Valuation Premise sections of the Statement be relocated, and paragraphs C42 and C58 modified, so as to clearly indicate that their concepts are not relevant to Level 1 or Level 2 estimates of fair value.
AcSEC believes that nonfinancial assets and liabilities, as well as illiquid financial assets and liabilities, would typically be more likely than liquid financial assets and liabilities to require measurement using Level 3 estimates. Level 3 estimates require the most judgment among the levels of estimates in the determination of fair value. Accordingly, AcSEC believes that a final Statement should provide additional guidance, perhaps through additional examples in Appendix B, relating to nonfinancial assets and liabilities, such as real estate or intangible assets acquired in a business combination, impaired assets, or warranty liabilities. One possible example is the use of the multi-period excess earnings method (a form of discounted cash flow analysis) to estimate the fair value of intangible assets acquired to be used in research and development activities, for purposes of allocating purchase price pursuant to FASB Statement No. 141, Business Combinations.

ISSUE 8
Blockage
AcSEC continues to believe that the FASB should explore ways of considering blockage in fair value calculations. AcSEC recommends that the FASB consider specifically the scenario in which liquidity considerations prevent an entity from selling a portfolio for the sum of the individual security prices for an extended period of time. It is unclear in that scenario that the market for portfolios is “active” or that the entity has “immediate access” to the market.

If, in view of reliability and consistency concerns, the Statement requires that the impact on value of blockage or other liquidity factors not be considered in the determination of the fair value of securities, AcSEC believes that the existence of those factors should nonetheless be brought to the attention of financial statement users. A company owning one or more “large” blocks of securities fair valued on a price-times-quantity basis under the Statement should disclose the fact that the measurement of a block at fair value in financial statements does not necessarily (or likely does not) imply that such value would be realizable if the block was sold in a single transaction.

AcSEC is also unclear why the ED limits the blockage concept to broker-dealers and investment companies (as discussed in footnote 5 to paragraph 6), in view of paragraph 15 of FASB Technical Bulletin No. 85-6, Accounting for a Purchase of Treasury Shares and Costs Incurred in Defending against a Takeover Attempt. That latter paragraph states, “a block of shares representing a controlling interest will generally trade at a price in excess of market, and a large block of shares may trade at a price above or below the current market price depending on whether the buyer or seller initiates the transaction.” [Emphasis added] AcSEC is unclear how the Technical Bulletin would be applied if the proposed Statement is finalized.

AcSEC further observes that through footnote 5 to paragraph 2.30 in the AICPA Audit and Accounting Guide, Audits of Investment Companies (the Guide), the use of blockage factors was grandfathered for investment companies that used blockage factors in certain circumstances on or before May 31, 2000. Such grandfathering was put in place, at the Board’s request, pending the finalization of the Board’s “Disclosures about Fair Value”
The grandfathering has resulted in inconsistency in application of blockage factors—not only between the financial statements of investment companies that applied such factors prior to the May 2000 cutoff date and those that were not permitted to after that date, but also between the financial statements of investment companies and those of broker-dealers, as broker-dealers do not have a similar restriction on the application of blockage factors. AcSEC believes that the third sentence of footnote 5 to paragraph 6 of the ED should be modified to include, among the “various factors,” a reference to the cutoff date in the Guide. More importantly, AcSEC believes that the FASB should timely elevate the priority of dealing with blockage in its fair value project in order to eliminate as quickly as possible the Guide’s grandfathering, cutoff date, and resulting inconsistencies.

The Board may wish to consider expanding the Statement’s discussion on blockage beyond securities. For example, as discussed later under “Unit of account,” the concept may be considered applicable to sales of real estate lots. The fair value of a property consisting of a large number of individual building lots may not best be determined as the product of the number of lots times the price of an individual lot.

Conceptually and most importantly, AcSEC is concerned by the notion that if the fair value of a block of securities is always determined as simply the sum of the individual security prices, that could lead to the conclusion that a minority interest per-share fair value is the same as that of a controlling interest per-share fair value. The price of a trade of 2 percent of an entity’s shares, for example, is not necessarily an indication of the price at which control would be transferred. Such use of unadjusted price time quantity is an example of how one might obtain Level 1 evidence of fair value but where the Level 1 evidence alone does not seem to represent fair value. Even in view of Level 1 evidence, the size of the block may have a significant effect on the value of the shares. AcSEC believes the Board should resolve this issue before issuing a final Statement.

ISSUE 2
Inconsistencies with CON 7
From a broad, procedural perspective, AcSEC believes that Concepts Statement modifications should precede corresponding modifications of other accounting literature because Concepts Statements should be the foundation on which other accounting literature should be based. From a more focused perspective, AcSEC is concerned that there are differences between the guidance in the proposed Statement and the guidance in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, and believes the Board should amend Concepts Statement No. 7 (which is not currently listed in Appendix D as requiring amendment) so that a final Statement and the Concepts Statement are consistent.

An example of such difference is the discussion of Methods 1 and 2 in paragraph A12 of the proposed Statement, which appears to differ from Concepts Statement No. 7 in terms of how expected cash flows may be adjusted for risk. Similarly, paragraphs A12 and A17(a) of the ED discuss certainty-equivalent cash flows and paragraphs A5 (footnote 12), A16, and C40 discuss systematic or nondiversifiable risk, which are concepts that are
not discussed in Concepts Statement No. 7. Further, paragraphs A5 through A7 of the ED make certain broad statements about risk and uncertainty that are inconsistent with Concepts Statement No. 7.

ISSUE 11
Disclosures
AcSEC is unclear why a Statement on how to measure fair value under other authoritative pronouncements would require disclosures above and beyond the disclosures already required under those pronouncements. AcSEC recommends that prior to the possible addition of a new “layer” of required disclosures, the Board perform a comprehensive study of all existing disclosure requirements related to fair value measurements. AcSEC recommends further that such study incorporate a focused consideration of the needs of stakeholders of public and privately held entities.

ISSUE 13
Issues not addressed in the Statement
AcSEC observes that it may be helpful for the proposed Statement to point out that there are issues relating to fair value measurement that the Statement does not address. For example, consider situations in which fair value will be measured, using a Level 3 estimate, subsequent to a specific exchange transaction. If the Level 3 estimation technique were applied at the transaction date, the result may differ from the actual transaction price. The Statement does not address how to deal with such difference. AcSEC points out that a recent IASB exposure draft (Proposed Amendments to IAS 39, Financial Instruments: Recognition and Measurement, Transition and Initial Recognition of Financial Assets and Financial Liabilities—in particular, paragraphs 7, AG76A, and BC16) suggests focusing on changes in valuation from the transaction date estimate in this case.

The situation described in the previous paragraph arises when, for example, the item is a unique item, the item is available only in an illiquid market, or the parties to the transaction have different underlying valuation premises for the item. It frequently arises in over-the-counter derivative transactions both with respect to the dealer that is valuing the position for purposes of valuing its trading book and the user that is determining the fair value of the instrument for purposes of applying the guidance of FASB Statement No. 133. The treatment of the difference on the transaction date is addressed in Issue 2 of EITF Issue No. 02-3, “Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities” in the Issue’s consideration and recognition of dealer profit based on fair value measurements. However, there is currently a lack of guidance as to how to treat this difference after the transaction date. AcSEC believes that such situations should be addressed in this Statement (notwithstanding the discussion in paragraph C23 of the ED) but understands that the Board may need to address them in a later phase of its fair value measurement project.

ISSUE 13
Other measurement attributes
The proposed Statement addresses only the fair value measurement attribute. Paragraphs 66 through 70 of FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements of Business Enterprises, describes five different measurement attributes: historical cost, current cost, current market value, net realizable value, and present value of future cash flows. Moreover, there exist other “standards of value” (a term used in the International Glossary of Business Valuation Terms) such as intrinsic value, investment value, liquidation value, and current value. AcSEC recommends that the Board, in a final Statement, consider acknowledging the existence of some or all of those attributes or standards of value and noting that as the Board embarks on Phase II of the project, it may further consider the appropriateness of the use of those attributes or standards in certain circumstances.

Comments and Recommendations on Key Concepts

ISSUE 1
Introduction; “market value” – The Introduction states that the purpose of the proposed Statement is to provide guidance on how to measure fair value. AcSEC observes that another, unstated purpose/consequence is to extend application of the fair value concept to certain pronouncements (see in paragraph D11, for example, the amendments to Statement 65) previously employing “market value.” AcSEC recommends that the Board consider alerting readers in the Introduction (or elsewhere) to this additional purpose/consequence and indicate whether its intent is that “market value” is to be defined as synonymous with “fair value.” In addition, the Board should consider listing in an appendix those pronouncements to which this extension of the fair value concept applies. The Board also should consider clarifying in such appendix the meaning of “market value,” and why the term was not changed to “fair value” in those pronouncements, if any, in which the term “market value” remains unchanged after the issuance of a final Statement.

ISSUE 5, 13
Introduction; valuation standards and practices – The last sentence of the Introduction refers to “applicable valuation standards and generally accepted valuation practices.” AcSEC believes it may not be clear to all readers what this phrase refers to and recommends that the Board consider referring instead to “valuation standards promulgated by widely recognized professional valuation organizations and valuation practices generally employed by their members.” (For simplicity we will abbreviate as “professional valuation standards and practices” where the concept is referred to throughout the remainder of this letter.)

ISSUE 1
Scope – AcSEC is concerned that, by the proposed Statement scoping out certain pronouncements that use the term “fair value,” such as FASB Statement No. 13, the meaning of “fair value” will become unclear because the term presumably will have one meaning under the proposed Statement and another, different meaning under the scoped-out pronouncements. AcSEC believes that, ideally, a broad-based Statement on
measuring fair value should apply to all instances in the literature in which the term “fair value” appears. The Board should clarify in the proposed Statement how the term “fair value” should be interpreted (and measured) in those pronouncements that the proposed Statement scopes out.

Assuming, however, that there will be scope-outs in this phase of the Board’s fair value project, AcSEC believes that, because the proposed Statement is so broad-based, there should be a high threshold for such scope-outs. AcSEC understands the proposed scope-out of pronouncements that address revenue recognition transactions measured using vendor-specific objective evidence (VSOE) of fair value and share-based payments because those are being addressed in current and active Board projects (but see next paragraph with respect to the proposed scope-out of EITF Issue No. 00-21). However, AcSEC questions why it is necessary to scope out inventory pricing, because the concept of “market” as used in the term “lower of cost or market” and as defined in Statement 6 of Chapter 4 of ARB No. 43 is not fair value. A footnote could be added to ARB No. 43 to emphasize that “market” is not “fair value” as defined in the Statement. AcSEC also questions why it is necessary to scope out FASB Statement No. 114 when, as indicated in paragraph C18 of the ED, the present-value measurement objective under FASB Statement No. 114 is not fair value. Furthermore, when the fair value practical expedient of Statement 114 is used, AcSEC is unclear why fair value so determined should not be “fair value” as determined under the proposed Statement. Finally, AcSEC is unclear in reading paragraph C14 of the ED why (and how) measuring the fair value of leased property should be performed differently than under the proposed Statement.

AcSEC questions the scope-out of EITF Issue No. 00-21 in paragraph 2(a) of the Statement, which the Statement justifies by noting that the Issue addresses revenue recognition transactions measured using VSOE of fair value. The Issue makes numerous references to fair value, but it is only paragraph 16 of the Issue that refers to VSOE. AcSEC recommends that the Issue not be scoped out, but rather that the Status section of the Issue be updated to reflect the nullification (or modification) of paragraph 16 as a result of the issuance of a final Statement on fair value measurements.

ISSUE 1

Fair value of services – The Introduction to the ED states that the objective of the Statement is to provide guidance on how to measure fair value and that the Statement applies to assets and liabilities. AcSEC believes that this statement should also refer to services. Services are required to be measured at fair value, for example, in Examples 1 and 3 through 7 of EITF Issue No. 00-21 and by Statement 116, Accounting for Contributions Received and Contributions Made. AcSEC further believes it may be helpful to include in Appendix B an example of measuring fair value of services.

The Board should clarify whether the Statement applies to measuring fair value of contributed services received by not-for-profit organizations as discussed in paragraphs 9 and 10 of Statement 116, particularly contributed services that do not create or enhance a nonfinancial asset. AcSEC believes that, pursuant to paragraph 5 of Statement 116, contributed services are considered an “other asset,” and the valuation of such services
therefore would be within the scope of the fair value Statement. AcSEC further believes that the proposed revisions to paragraph 19 of Statement 116, as provided in paragraph D18 of the fair value Statement, imply that the fair value of all contributed services should be determined based on the provisions of the fair value Statement. Nevertheless, AcSEC believes it would be helpful if the Board more explicitly communicated the applicability of the proposed Statement to contributed services that do not create or enhance a nonfinancial asset. For example, paragraph 19 of Statement 116 could be revised to include a footnote after the revised first sentence (the sentence ending with a phrase "...of the asset enhancement resulting from the services."). Such footnote could be worded: "The fair value of contributed services other than those that create or enhance nonfinancial assets should be measured in conformity with FASB Statement No. XXX, *Fair Value Measurements.*"

**ISSUE 1**

*Definition of fair value* – AcSEC recommends that the Board clarify that the term "unrelated" in the definition of fair value signifies other than a related party as defined in FASB Statement No. 57, *Related Party Disclosures.* AcSEC observes that paragraph 16 of FASB Interpretation No. 46-R, *Consolidation of Variable Interest Entities,* defines related parties and de-facto agents as a group for purposes of the Interpretation. AcSEC observes also that Item II.C., "Disclosures About Effects of Transactions with Related and Certain Other Parties," of SEC Release No. FR-61, "Commission Statement about Management’s Discussion and Analysis of Financial Condition and Results of Operations," indicates that consideration should be given to relationships that might cause dealings between parties to be at other than arm’s length despite the parties not being considered "related parties" under Statement 57. For example, an entity may be established and operated by individuals who were former senior management of, or have some other current or former relationship with, another entity.

**ISSUE 6**

*Unit of account* – AcSEC believes that the principle of the first sentence of paragraph B9, which is that the reference market is the most advantageous market to which an entity has immediate access, is applicable whenever a market approach is being applied. That is, the principle is applicable not only to Level 1 estimates but also to Level 2 and 3 estimates, and the concept of "reference market" should be considered in estimating fair value under each of the three Levels. AcSEC also believes the concept is sufficiently important that it should appear in the up-front portion of the Statement rather than in an appendix. Moving the concept from paragraph B9 to paragraph 6, for example, would not only emphasize the importance of the concept but also clarify its broad applicability. AcSEC believes that including the reference market concept in a discussion of unit of account would be helpful in resolving issues for which the reference market concept is germane. For example, consider the following questions:

1. If a loan is part of a portfolio, how should the loan’s fair value be determined? One view is that fair value should be measured by considering the loan by itself without reference to it being in a portfolio. An alternative view is that one first
determines the fair value of the portfolio and then imputes a portion of that value back to each individual loan.

2. How should undeveloped real estate that will be developed into individual building lots be valued? One view is that the existing property should be valued in its current state. An alternative view is to value, taking into consideration the development costs to be incurred, the individual lots.

3. How should a portfolio of fully developed real estate properties be valued—individually, or the group of properties as a package?

4. How should intangibles in a business combination be valued—as a single asset consisting of the group of intangible assets, or the individual intangible assets?

Assuming that a final Statement were to clarify that the reference market concept applies to all three Levels, AcSEC recommends that paragraphs 16 (as illustrated in paragraph B9) and 23(f) be reconciled or modified. Under paragraph 23(f), in determining fair value, a quoted market price might need to be adjusted based on location. But under paragraph 16, although costs to transact in various markets are to be considered in determining what constitutes the “most advantageous market,” the price used to estimate fair value is not to be adjusted for those costs. Consider as an example the determination of the fair value of most commodities such as grain when quoted market prices are available. Assuming that the costs of transportation to various markets are appropriately considered costs to transact in those markets, paragraphs 16 and 23(f) appear to be inconsistent as to whether the transportation costs should or should not be reflected in the estimate of the fair value of the grain.

AcSEC recommends also that a final Statement clarify whether the unit of account could be smaller than an existing contractual arrangement—for example, whether in measuring fair value a derivative should be disaggregated into components such as interest, credit, and currency risks, as is often the case currently.

ISSUE 4
Valuation Techniques and Valuation Premise sections, applicability only to Level 3 estimates – AcSEC notes that “valuation techniques” and “valuation premises” are not discussed in the proposed Statement in conjunction with Level 1 or 2 estimates and, as previously mentioned, recommends that the Valuation Techniques (paragraphs 7 and 8) and Valuation Premises (paragraph 13) sections be incorporated into the section in which Level 3 estimates are discussed. The discussions of Levels 1 and 2 should not allow for the option of using valuation premises or techniques other than a market approach to develop an estimate of fair value.

ISSUE 5
Valuation techniques, general – Consistent with the previous comment, AcSEC recommends adding “under Level 3” at the end of the first sentence in paragraph 7. As it currently reads and in its current location in the proposed Statement, AcSEC believes the sentence may be incorrect. For example, in an estimate of a security’s fair value in which one has a currently quoted market price for that security, the guidance on Level 1
estimates does not appear to allow for the consideration of "valuation techniques consistent with the market approach, income approach, and cost approach."

ISSUE 9
Valuation techniques, consistency – AcSEC believes that paragraph 8 overemphasizes consistency and is overly restrictive as to the circumstances under which changes in valuation technique(s) used are appropriate. AcSEC recommends that the paragraph (1) point out that the objective of valuation techniques is to obtain the best possible estimate of fair value and (2) note that consistency is important, but not the only consideration, in the achievement of that objective. AcSEC believes that the paragraph’s listed restrictions on changing valuation techniques leave out other circumstances in which changes may be appropriate, such as previous markets disappearing (e.g., the markets for bonds issued by a foreign country that has had a recent change in government), a significant decrease in the ability of the entity to obtain the information necessary to apply a technique without undue cost and effort (see paragraph 21), or even preparers realizing that an alternative valuation technique will provide a superior estimate of fair value.

ISSUE 3
Market inputs – Auction markets (as exemplified in the competitive bidding scenario in paragraph B3) are becoming increasingly prevalent in the marketplace, and AcSEC believes that paragraph 11, which discusses examples of markets, would benefit from inclusion of a discussion of auction markets. It is currently unclear into which (if any) of the categories discussed in the paragraph an auction market would fit. AcSEC also believes it may be helpful to augment the discussion of the “direct” market inputs listed in paragraph 12 with a discussion of “indirect” market inputs, such as pricing services.

ISSUE 4
Valuation premise – AcSEC has the following comments on paragraph 13:

1. The valuation premise concept discussion is useful but may benefit from additional examples in Appendix B illustrating how to make the concept operational. For example, does the in-use valuation premise incorporate a concept of “highest and best use”? If prime Manhattan real estate could be sold from one bowling alley owner to another, or from an office space owner to a bowling alley developer, or from a bowling alley owner to an office space developer, what is the appropriate valuation premise in each case and how should the valuation of the real estate relate to the valuation premise? An example illustrating the applicability of the valuation premise concept to intangibles would also be helpful. A company may purchase a trade name with the intent of enhancing the company’s competitive position by holding but not using the trade name, or the company may purchase the trade name with the intent of marketing it to third parties. What is the appropriate valuation premise in each case and how should the valuation of the trade name relate to the valuation premise?

2. AcSEC believes readers might better understand the concept of a valuation premise if the first two sentences stated, "A valuation premise is based on the intended use by marketplace participants of an asset or liability. It is the basis for
certain of the assumptions that market participants would use in their estimates of fair value.”
3. The discussion in the paragraph does not appear to be universally applicable. In fact, it seems generally inapplicable to financial instruments, particularly those that trade in active markets. If it is retained as a general concept, it would help readers if it were made clear how the concept of valuation premise applies (or does not apply) to liabilities or financial assets that have market prices from liquid markets.
4. The paragraph states that a going-concern or in-use valuation premise presupposes that marketplace participants would continue to use a business that is a going concern or an asset that is configured for use by an entity. The concepts of going concern or in-use appear to be less market-based than based on “entity inputs based on an entity’s own internal estimates and assumptions” (see paragraph 24)—for example, the assumption of continued use of a machine in income-producing activities of a combined entity as discussed in paragraph B7(a). As previously discussed, it would be helpful to further clarify the relationship between intent (whether of marketplace participants or of the entity) and the valuation premise concept.
5. AcSEC is unclear what valuation premises are appropriate in addition to the going-concern or in-use valuation premise and the in-exchange valuation premise mentioned in the paragraph. If there are others that are appropriate in the measurement of fair value, it would be helpful to state them. If there are no such others, then AcSEC recommends that the sentence “Otherwise, an in-exchange valuation premise may be appropriate” should be modified to read, “Otherwise, an in-exchange valuation premise would be appropriate.”
6. The valuation premise concept is illustrated in Example 3 in paragraph B7. AcSEC believes it would be helpful if the Board would provide a reconciliation of Example 3 to the guidance in Statement 144 on assets held for use or held for sale. In paragraph B7(a), for example, the statement that a machine “will continue to be used” does not necessarily mean that the machine will meet Statement 144’s criteria to be considered held for use. Similarly, in paragraph B7(b), the statement that a machine “will be sold” by the combined entity does not necessarily mean that the machine will meet Statement 144’s criteria to be considered held for sale. The distinction is important because the held-for-use measurement (fair value) differs from the held-for-sale measurement (lower of carrying amount or fair value less cost to sell).

ISSUE 7

Level 1 estimates, bid and asked prices – Paragraph 17 provides guidance applicable to Level 1 estimates. AcSEC notes that, although many derivatives (for example, interest rate swaps) are currently and will continue to be valued using Level 3 estimates, many securities dealers value such derivatives as described in paragraph 17 with respect to the guidance on bid/asked prices even absent the “active dealer market.” Accordingly, AcSEC recommends that the paragraph be moved appropriately in order to clarify that its guidance applies not only to Level 1 estimates but also to certain Level 2 and 3 estimates. AcSEC further believes that an example (such as an example on the use of short positions
to estimate liabilities, incorporating an illustration of the use of mid-market prices for the
matched portion in the case of offsetting positions) in Appendix B would help illustrate
the application of this paragraph.

In addition, AcSEC is concerned that footnote 8 to paragraph 17 will be misinterpreted.
As explained in paragraph C53 of the ED, the Board intends paragraph 17 to incorporate
the approach used in IAS 39 (revised), Financial Instruments: Recognition and
Measurement, which requires the offsetting of contracts based on risk (and not
incorporate guidance from FASB Interpretation No. 39, Offsetting of Amounts Related to
Certain Contracts, which addresses the legal right of offset). To clarify this, AcSEC
recommends that the footnote specifically differentiate offset by risk for purposes of
valuations and offset by legal right for purposes of balance sheet presentation.

ISSUE 13
Level 1 estimates, significant events – AcSEC observes that allowing entities to come up
with their own policies for recording significant post-market-close events may result in
decreased comparability among entities recording fair value measurements. The Board
should acknowledge this in Appendix C along with a discussion of which factors the
Board considered that would offset the decrease in comparability.

ISSUE 5
Level 2 estimates – It is AcSEC’s understanding that some valuation professionals
believe fair value estimates consist only of Level 1 or Level 3 estimates, that is, those
professionals question the existence of Level 2 estimates. AcSEC also struggled with
identifying Level 2 estimate scenarios. AcSEC therefore recommends clarification of the
term “objectively determinable” in the definition of a Level 2 estimate. Examples of
scenarios in which the price effect of differences is or is not objectively determinable
would help readers, as would a list of criteria for determining whether or not a price
effect is objectively determinable. (AcSEC observes that Appendix B includes examples
relating specifically to Level 1 and Level 3 estimates and suggests that examples be
added of Level 2 estimates.)

ISSUE 9
Level 3 estimates – Paragraph 21 states that multiple valuation techniques should be used
to estimate fair value, but AcSEC believes readers may be confused by this statement
because paragraph 7 appears to state that multiple valuation techniques should be
considered for use. AcSEC believes that the concept of considered for use is appropriate
for paragraph 21, but in any case, as previously mentioned, believes clarification is
necessary.

ISSUE 13
Transition – AcSEC recommends that the proposed Statement clarify that prospective
application refers to the next instance that an entity is required to measure the fair value
of a specific asset or liability—for example, at the next instance that an impairment (and
concomitant remeasurement) occurs under Statement 144.
ISSUE 2

Present value techniques, elements considered – Paragraph A2 lists several elements that should be captured in a fair value estimate using present value. The discussion of elements a, b, c, d, and f are readily found in the ensuing paragraphs in Appendix A, but the discussion of how element e, “other case-specific factors, such as liquidity and market imperfections,” should be captured is not so clearly discernible in the ensuing paragraphs. It would be helpful to readers to clarify, possibly through an example, how element e should be captured, or to refer readers to where in the ensuing paragraphs (for example, paragraph A10) additional discussion of element e may be found.

ISSUE 13

Synergies – Paragraph B3 states that the premium in a competitive buying situation would not necessarily reflect the value of buyer-specific synergies and that it would not necessarily reflect an overpayment (which AcSEC interprets to mean a payment greater than fair value). The conclusion is that the exchange price in the transaction would represent fair value. But stating that the premium would not necessarily represent buyer-specific synergies or an overpayment implies that the premium could represent buyer-specific synergies or an overpayment, and the conclusion would nonetheless remain that the exchange price represents fair value. AcSEC recommends that the explanation in this paragraph be enhanced to address the scenarios of a premium representing buyer-specific synergies or a premium representing overpayment. Additionally, it is not clear from this paragraph whether (or how) one should attempt to determine if the premium reflects buyer-specific synergies or represents an overpayment.

ISSUE 9

Application of multiple valuation techniques – AcSEC commends the Board for the representativeness of the examples in paragraphs B11 through B16 (market and cost, with market being selected; income and cost, with income being selected; and income and cost, with cost being selected). It may be helpful also to include an example in which cost is not one of the approaches used (that is, market and income are the two approaches used) and an example in which the final fair value estimate is neither of the estimates determined under the two selected approaches but rather is between the two approaches.

It is AcSEC’s understanding that, under professional valuation standards and practices, a valuation specialist is required to consider the cost, market, and income approaches to the valuation of an asset. Within the meaning of consider is the latitude not to use one of the approaches if it is inappropriate to the valuation of the asset or if the data necessary to employ the approach is not available. The valuation specialist is then required, under professional valuation standards and practices, to reconcile the results produced by the approaches and then render his or her opinion of value. The reconciliation process includes reexamining the quality of the data used in the approaches and may result in selecting a value that is the result of assigning “weights” to the values determined under the multiple approaches. Accordingly, it is AcSEC’s understanding that under professional valuation standards and practices, a valuation specialist is not precluded from judgmentally weighting various approaches and methods and selecting a final fair value estimate that is not necessarily identical to one of the individual estimates.
determined under those methods and approaches. It would be helpful for the Statement to illustrate this concept in an example to avoid confusion in the future.

ISSUE 9
*Valuation practice versus illustration of valuation approaches* — Paragraph B12 of Example 6 illustrates an application of the cost and market approaches to the valuation of machinery assuming an in-use valuation premise. The example concludes that the market approach is superior because its market inputs of quoted prices for used machinery are more relevant and reliable than the cost approach's market inputs of quoted prices for new machinery, as the quoted prices for used machinery require fewer and less subjective adjustments for differences. AcSEC believes the example is oversimplified and may be misleading because it does not reflect the more typical valuation scenario of having to value a large number—possibly hundreds or thousands—of individual pieces of machinery that are installed, and engineered and configured to comprise one or more manufacturing lines. It would not be realistic, or cost-effective, for a valuer to locate and inspect comparable pieces of equipment, obtain prices, and then adjust the prices for differences between the comparable equipment and the subject pieces of equipment. Furthermore, the sum of the adjusted used equipment prices would not include the component of fair value attributable to installing and configuring the machinery to operate as an integrated manufacturing line (the "in-use" premise of value). The predominant method used in practice by valuers for in-use valuations is indexing, which is a cost approach. Indexing starts with the historical costs of engineering, acquiring, installing, and testing the machinery, adjusts them upwards based on published comparative cost indexes to obtain current costs, and then adjusts them downward based on "depreciation" due to physical usage, obsolescence, and economic factors. For certain major items of machinery, the values so obtained are compared with and reconciled to market prices for used machinery. The practice of indexing is well established in the valuation community and those parties that the valuation community deals with (auditors, regulators, taxing jurisdictions, and courts). AcSEC is concerned that Example 6 could be interpreted by some as requiring a change in well-established and accepted valuation practice, and believes that it would be more helpful to readers if the Statement included a more realistic example of machinery and equipment valuation.

ISSUE 10
*Restricted securities, concepts of “active market” and “thin market”* — Paragraph B18(d) uses the term “thin market.” AcSEC believes it would be helpful to readers if that term were reconciled to the term “active market” that is used throughout the ED. For example, it is unclear whether a thin market would necessarily not constitute an active market. Further clarification, including examples, of the term “active market” would be helpful as well.

ISSUE 10
*Restricted securities, amortization of discount* — Paragraph B18(f) includes guidance on the impropriety of amortization of a discount. AcSEC questions the inclusion of prescriptive guidance on amortization in the Implementation section of a Statement on measuring fair value. Moreover, under the proscription against amortization over an
“arbitrarily chosen” period, AcSEC is concerned that is may be unclear whether it is possible for an entity to justify the use of a period that is not “arbitrarily” chosen, such as the contractual term of the restriction, and thereby amortize over that period.

ISSUE 9
Basis for Conclusions discussion of other valuation techniques – Paragraph C42 states that the “Statement emphasizes the need to consider valuation techniques that apply the market, income, and cost approaches, especially for Level 3 estimates.” [Emphasis added] AcSEC finds this confusing because “especially for Level 3 estimates” implies that the three approaches would be used sometimes for Level 1 and 2 estimates, and the Statement appears to prescribe that Level 1 and 2 estimates are to be made without application of the cost or income approaches. (For example, paragraph C45 states, “For a Level 1 estimate, a quoted price in an active market represents the sole market input.”)

ISSUE 9
Basis for Conclusions discussion of Level 3 estimates – AcSEC has the following comments on paragraph C58, which AcSEC believes would benefit from clarification:

1. As discussed above under Valuation techniques, general, AcSEC does not perceive that, based on the discussions of Level 1 and 2 estimates (paragraphs 15 through 20), the Statement should require consideration of multiple valuation techniques for Level 1 or 2 estimates. The first sentence of paragraph C58 implies that such consideration is required even for Level 1 and Level 2 estimates.

2. The second sentence of paragraph C58 states that, for Level 1 and Level 2 estimates, “the results of other valuation techniques may not provide significant additional information about those estimates.” [Emphasis added] It would be helpful to readers if, assuming the final Statement does require consideration of multiple valuation techniques even for Level 1 estimates, an illustration could be provided of a situation in which the results of additional valuation techniques would provide significant additional information.

3. It is unclear whether the last sentence of paragraph C58 is in the context of Level 1 and 2 estimates only, or of Level 1, 2, and 3 estimates. If the latter, the statement that “the objective is to select the valuation technique that best approximates what an exchange price would be” [emphasis added] seems at odds with the statement in paragraph C57 that “an estimate based on the results of multiple valuation techniques is likely to be more reliable than the results of a single valuation technique.” Contrary to paragraph C58, AcSEC perceives that the result of applying (say) two valuation techniques could be that the final estimate of fair value is somewhere in between the individual results of the two techniques, and not necessarily that the estimate of fair value is required to be the estimate derived from one of the two techniques.

ISSUE 13
Affected pronouncements – AcSEC believes it would help readers to see in Appendices D and E which EITF consensuses would be affected by a final Statement and how they...
would be affected. If no EITF consensuses are affected by a final Statement, it would be helpful to point that out to readers.

ISSUE 13
Amendment to Statement 13 – In paragraph D5, AcSEC is concerned with the deletion from Statement 13 of the guidance on how to determine interest expense using APB Opinion No. 21, Interest on Receivables and Payables. AcSEC is concerned that users will be confused as to how to determine interest expense in light of that deletion and would prefer that the sentence in question be amended, so as to continue to provide guidance, rather than deleted.

ISSUE 2
Amendment to Statement 146 – AcSEC recommends amendment or deletion in paragraph D27 of the ED of footnote 17 to paragraph A9 and footnote 18 to paragraph A11 of Statement 146. Those footnotes deal with the consideration of a risk premium as part of a present value measurement that is performed as part of a fair value measurement. AcSEC believes that because the concept of considering or determining a risk premium as part of a fair value measurement is not only significant but also has applicability beyond determining fair value in conjunction with exit or disposal activities, the concept should be dealt with as part of the proposed Statement rather than retained in footnotes in a pronouncement on accounting for exit or disposal activities.

ISSUE 13
Cost benefit of proposed Statement – The discussion of costs and benefits appearing on page vii of the proposed Statement states that “some entities will need to make changes to comply with the requirements of this proposed Statement, thereby incurring one-time costs.” AcSEC notes that entities will also incur the ongoing costs of compliance in that, in measuring fair value under the proposed Statement, they may need to consider, on an ongoing basis, methods and factors (and document such consideration for audit purposes) over and above those considered previously. Entities may also need to hire specialists to assist with ongoing measurements because of the additional considerations.

Other Comments and Recommendations

ISSUE 1
Paragraph 5 – The third sentence should either add the word “Unrelated” at the beginning of the sentence or delete the word “unrelated” that currently appears in the sentence.

ISSUE 2
Paragraph 7(b) – AcSEC is confused by the reference in the first sentence to discounting earnings and recommends deleting “or earnings” to make the paragraph consistent with the references to discounting cash flows that are used throughout Appendices A, B, and C of the proposed Statement.

ISSUE 9
Paragraph 7(c) – It would be helpful to readers if the discussion of how the cost approach applies to an asset was supplemented by a discussion of how the cost approach applies to a liability (or by a statement that the cost approach is not applicable to a liability, if that is the case).

ISSUE 5
Paragraph 12(b) – It may be helpful to include nonfinancial market inputs, such as building occupancy levels, in addition to the financial market inputs listed.

ISSUE 4
Paragraph 13 – The last sentence might be clearer if the words “based on the selected valuation premise” were added at the end. That addition may more clearly link the sentence with the concept of valuation premise.

ISSUE 4
Paragraph 13 – AcSEC believes some readers may confuse the marketplace-participant-related concept of “in-use value” with the concept of “value in use,” which would include entity-specific synergies not available to general market participants. It may be beneficial to include a discussion in the Statement clarifying the difference. If the reference in FASB Concepts Statement No. 7 (paragraph 24(b)) that equates value in use to entity-specific value were to be removed, that could alleviate the confusion.

ISSUE 6
Paragraph 18 – This paragraph states that an entity should apply “a policy” whereas paragraph C54 states that an entity should apply “written policies.”

ISSUE 5
Paragraph 23 – Paragraph 23(b) uses the term “sufficiently determinable” whereas paragraph 20 uses the term “objectively determinable.” The Board should consider whether these terms should be the same, or clarify the use of the former.

ISSUE 10
Paragraphs B18, B19 – It may improve the flow of the document to place paragraph B19 before B18. The document would then read that, although there is no automatic formula for determining the fair value of restricted securities, there is certain guidance one should apply in any such determination (followed by items a through f in the current paragraph B18).

ISSUE 10
Paragraph B18(e) – It may be helpful to clarify how the company and issuer could be different parties, as some readers may perceive that the company is necessarily the issuer. Replacing “company” with “holder” may provide such clarification.

ISSUE 11
Paragraph B22 – The long-lived asset held for sale in the example would be measured under Statement 144 at the lower of carrying amount or fair value less cost to sell. It
therefore would be measured on a nonrecurring or periodic basis (see paragraph 25(b)) and appears to be out of place in this example of assets remeasured on a recurring or ongoing basis. In addition, AcSEC believes some readers may find it confusing that the 15% figure representing percent of total assets appears at the bottom of the column labeled “Significant Entity Inputs.”

ISSUE 7
Paragraphs C47, C50 – AcSEC believes that the informative guidance in paragraph C47 on the meaning of bid and asked prices is helpful and recommends that such informative guidance be extended to clarify the meaning of bid and asked prices in the case of a liability. Some readers may be confused in trying to apply the informative guidance to a liability because a liability is not “sold”; rather, an entity pays another entity to assume a liability. AcSEC similarly believes it would be helpful to provide further informative guidance on the application of the concept of “short position,” which is typically thought of in connection with a stock (i.e., asset), to a liability, as discussed in paragraph C50.

* * * * *

We appreciate the opportunity to comment on the ED. Representatives of AcSEC would be pleased to discuss our comments with the Board members or staff.

Sincerely,

Mark Bielstein, Chair
Accounting Standards Executive Committee

Michael Joseph, Chair
Fair Value Task Force