September 00, 2004

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

Re: File Reference 1201-100

Dear Ms. Bielstein:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants appreciates the opportunity to provide its views on the Exposure Draft (ED), “Fair Value Measurements”. Our responses to the specific issues raised in the ED are contained in the Attachment.

While we generally support the objective of the ED to provide guidance that will increase the consistency and comparability of fair value information, we believe that the document falls well short of its goal. Importantly, we believe it is first necessary to understand more about the extent and intended use of fair value measures before proceeding to define specific measurement approaches. We realize this means the Board would first need to fully address the issue of the relevance of fair value measures to the users of financial statements, but we believe this debate is critical in order to put the fair value measurement standard in the proper context. Beyond that, we have continuing concerns about the reliability of fair value measures beyond certain financial instruments or other assets and liabilities with readily available market information.

On the issue of relevance, FRC remains concerned that the Board continues to move toward an expanded use of fair value, when the relevance of the information has not been adequately studied and justified.

Paragraph C3 of the ED states that “...users of financial statements generally have agreed that
fair value information is relevant.” While we acknowledge that, in the broadest sense, fair value is a relevant measure, we do not believe that the Board has demonstrated that users prefer fair value as the primary attribute for measuring the performance of an entity (i.e., in the income statement) or that fair value is the preferable measure for assets and liabilities that cannot or will not be sold, settled or exchanged. For example, an integrated oil company owns many thousands of service stations. Any, and all, of the stations can be sold and determining the FV of each is feasible. But of what use would that information be to shareholders or creditors if the company had no plans to exit the retail petroleum business? And if circumstances did dictate such an abrupt shift in business strategy, at that point the FV of the stations would undoubtedly be adversely affected.

While it is easy for certain users to say they would like fair value information, particularly when it costs them nothing to obtain, it is quite another to demonstrate what types of decisions could, or would, be made if the information were provided. We are not familiar with any recent research that comprehensively studies this issue and definitively concludes that users desire further fair value information – either in place of or in addition to the current bases of accounting.

The 1994 report of the Special Committee on Financial Reporting (the “Jenkins” Committee) provided direct evidence of user views on this issue. Page 14 of the summary version of that report states “While many users support disclosures of fair value information, particularly about financial instruments, they generally oppose replacing today’s historical cost-based accounting model with a fair value accounting model.” We believe that the findings of the Jenkins Committee support two fundamental views we have about fair value: (1) that users generally want historical cost for the basic financial statements for trend analysis, etc. and only would want fair value information as a disclosure item, and (2) that users generally are interested in fair values primarily in the context of financial instruments or assets to be disposed of.

Additionally, a report issued by Sirota Consulting in 1998, which summarized research jointly sponsored by the FASB and the Association for Investment Management and Research (AIMR), indicated there was “no clear consensus on the issue of reporting all financial instruments at fair value. A minority of participants were knowledgeable about fair value accounting for financial instruments. Among the knowledgeable minority, views were evenly divided between those who favored requiring financial instruments to be recognized and measured at fair value in the financial statements, and those who did not think that such a major change was warranted.” It should be noted that this study was issued over six years after fair value disclosure was required by Statement No. 107. Given there was no clear majority in favor of measuring even financial instruments at fair value, it is difficult to imagine there would be broad support for extending fair value measurement beyond financial instruments.

Reliability of fair value measures remains a concern, as well. As practitioners, auditors and valuation specialists, we have more than 40 years of practice in working with valuations of assets in financial statements (under APB 16 and its successors), but very little experience in valuing the assets and liabilities that the Board is now considering recognizing and measuring in financial statements. One significant difference is the absence of market transactions that exist with a
business combination or certain financial instruments. The ED is heavily focused on financial instruments, without much guidance on valuing non-financial assets. Such non-financial assets and liabilities require more judgment as to value, including consideration of management intent. The significance of the required judgments, in turn, drives the risk that the underlying relevance is impaired because the “value” is not sufficiently reliably determinable. This concern is further heightened by the follow-on impact to the auditing community and their ability to verify the underlying assumptions. We discuss additional factors that affect reliability in the attached response to specific issues.

Should the FASB decide to proceed with issuance of a standard without completing the more important work on fair value relevance, we believe it is critical that the final standard should not be viewed as either a license or a mandate for a broad expansion of the use of fair values in financial reporting. Paragraph C12 says that, "This Statement does not establish requirements for when to measure assets and liabilities at fair value. The Board expects to consider that issue on a project-by-project basis in individual pronouncements." We strongly support that statement and believe that the Board should spend significantly more time in its research activities focusing explicitly on the relevance of fair value in the context of the specific applications that will be addressed by new standards. In recent standards issued by the Board, it appears to us that the answer to the relevance question is either taken for granted, or is assumed to have been addressed by Concepts Statement 7. In either case, it is not clear to us that the Board’s decisions to require fair value measures in circumstances that do not involve financial instruments have improved financial reporting, and we do not wish to see that practice perpetuated in future standards without more emphasis on answering the questions of “what” and “why”.

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Please feel free to contact me at (513) 983-3874 if you have any questions regarding the comments contained in this letter.

Teri L. List  
Chair, Financial Reporting Committee  
Institute of Management Accountants
Appendix – Exposure Draft, “Fair Value Measurements”

Issue 1: This proposed Statement would define fair value as “the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties” (paragraph 4). The objective of the measurement is to estimate the price for an asset or liability in the absence of an actual exchange transaction for that asset or liability. Will entities be able to consistently apply the fair value measurement objective using the guidance provided by this proposed Statement together with other applicable valuation standards and generally accepted valuation practices? If not, what additional guidance is needed?

While the definition of fair value in the ED is fully in line with that used by valuation specialists, it doesn’t necessarily follow that the ED, as drafted, will result in entities being able to consistently apply the fair value measurement objective. We have four primary concerns: understandability to preparers, pervasiveness of management judgments, verifiability by auditors, and understandability by users.

There are many areas of the proposed guidance that are very difficult to understand and likely will result in many implementation issues – particularly for less sophisticated companies. Some of these are discussed in more detail in the following questions. Beyond that the ability to achieve consistency seems unlikely since implicit in fair value measures are a number of assumptions, many of which are heavily influenced by management judgments as to future actions and events. These will be heavily entity specific and not comparable across companies. We also question whether such judgments will be sufficiently verifiable – since they reflect only management intent, often in the context of an event at some point in the distant future. Finally, we believe it will be very challenging for users to understand the amounts determined using the guidance in the ED – assuming the issue of relevance discussed in our cover letter is overcome.

Issue 2: This proposed Statement would clarify and incorporate the guidance in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements (CON 7), for using present value techniques to estimate fair value (Appendix A). Is that guidance sufficient? If not, what additional guidance is needed?

We do not believe the guidance in Appendix A is sufficient. We believe the language is too theoretical and too focused on financial instruments to be of general use. It introduces terms such as, systematic and nonsystematic risk, diversifiable and nondiversifiable risk, and certainty equivalents that are not found in other FASB standards and that, we believe, are not well-understood by accountants. In addition, it provides little useful guidance concerning when or how those concepts are to be incorporated into fair value estimates.

We find the examples to be simplistic, and we are concerned that they provide little in the way of practical guidance concerning how one should go about determining how market participants might adjust expected cash flows or discount rates to reflect a market risk premium when such premiums generally are not independently observable in the marketplace for most assets and liabilities. Although paragraph A18 notes that the two methods described in paragraph A12
produce identical results, that is not an accident. It can be easily demonstrated that Method 1 as illustrated in paragraph A17(a) is algebraically identical to Method 2 as illustrated in paragraph A17(b). Therefore, given the assumptions stated in the example, no one would use Method 1 and the example serves only to illustrate the application of Method 2.

If the Board wants to provide a meaningful illustration of how Method 1 differs from Method 2, it needs to reiterate the guidance in paragraph A12 that the market risk premium can be incorporated into an expected-cash-flow-based estimate of fair value by adjusting the cash flows directly, which then are discounted at a risk-free rate (Method 1) or by increasing the risk-free discount rate by a risk factor and applying this risk-adjusted rate to the unadjusted expected cash flows (Method 2). Then the example should be revised to show how Method 1 would be applied if the appropriate market risk premium were determined to be $X and how Method 2 would be applied if the market risk premium were determined to be 3 percent. However, it also should be noted that if Method 1 and Method 2 were employed independently to estimate the appropriate market risk premium, it would only be coincidence that the two resulting fair values would be identical and we believe the statement in paragraph A18 suggesting otherwise is misleading and should be deleted. Likewise, we believe the comparison in paragraph A12 to the use of a certainty equivalent to measure the amount by which expected cash flows should be adjusted in applying Method 1 could be read to imply that there exists a “market” certainty equivalent that can be observed or estimated. The concept of a certainty equivalent is a construct of the decision-making-under-uncertainty branch of statistical inference. A certainty equivalent is unique to a given decision maker, reflecting his or her unique attitude toward risk for a given decision. It is not an estimate, but rather a tool designed to assist a decision maker in choosing between or among different alternatives whose probability-weighted expected values are similar. We believe that the implication that there is a market certainty equivalent that can be incorporated into fair value measurement based upon discounted cash flows is incorrect and that the reference to certainty equivalents in paragraph A12 and the related footnote 17 should be deleted from the final standard.

We also find the discussion concerning the use of risk-free versus risk-adjusted discount rates to be confusing, particularly as the ED describes two risk-adjusted rates: the risk-adjusted rate to be applied to expected cash flows (as illustrated in Method 2) and the risk adjusted rate to be applied to unadjusted cash flows (i.e., the discount rate for what CON 7 refers to as a “traditional approach” to measuring fair value using discounted cash flows). We do not find the Appendix helpful with respect to the problem of how one should go about independently quantifying the market risk premium adjustment to be included in either discount rate when it is not already embedded in a market-observable factor, such as the yield on a class of debt instruments of a given credit quality and tenor.

We note that footnote 18 suggests that one might use the Capital Asset Pricing Model to estimate a risk-adjusted discount rate. However, after observing that this and other theoretical pricing models require “strict assumptions that some find inconsistent with their perception of real-world markets or observed human behaviors” paragraph 71 of CON 7 concludes with the following observation concerning this and other theoretical pricing models that we believe to be directly applicable to most if not all fair value measurement problems involving assets and liabilities that
are not financial instruments: "Moreover, the asset and liability measurement problems most likely to prompt use of present value measurements are those least likely to satisfy the restrictive assumptions inherent in many theoretical models." We do not understand why the Board would suggest the use of a market risk premium discount rate-measuring model that is identified in its own Concepts Statement as unsuitable or of questionable reliability. Therefore, we recommend that footnote 18 be deleted from the final Statement or expanded to include the paragraph 71 cautionary language along with guidance that such models should not be used unless they can be shown to be appropriate to the measurement.

The proposed language in the ED concerning market risk premiums seems to indicate that such premiums can and should be incorporated into substantially all fair value measurements based upon discounted cash flows. We find this guidance to be in sharp contrast to the more cautionary language of CON 7, which Appendix A purports to summarize. If the Board concludes that it is appropriate to elevate the guidance in CON 7 to level A GAAP, we believe it should not exclude from Appendix A important guidance concerning the appropriateness of including market risk premiums in discounted cash flow estimates of fair value. Therefore, we recommend that the guidance in the final Statement include the language from the first sentence of paragraph 62 of CON 7 indicating that adjustments for market risk should only be included in such measurements if the amount of the adjustment is "identifiable, measurable and significant." Likewise, we believe the readers of Appendix A are entitled to know that in CON 7 the Board has concluded that "...an appropriate risk premium consistent with fair value may be difficult to determine" (the last sentence of paragraph 68) and that when a reliable measure of the market risk premium is not available, "...the present value of expected cash flows, discounted at the risk-free rate of interest, may be the best available estimate of fair value..." (the last sentence of paragraph 62).

In addition, we believe the principal premise underlying the market risk premium discussion (i.e., that market participants always charge a risk premium for bearing the risk of uncertain cash flows) is not supported either by market research or observed market behavior. We are aware that market research indicates that most decision makers are risk averse most of the time (although we do not believe such research would support the position implied by paragraph 66 of CON 7 that market participants are only risk seeking in markets such as gambling casinos and state lotteries). It does not follow that because most market participants are risk averse most of the time, markets themselves are always risk averse. Indeed, in a market where fair value is determined by the highest bidder with the authority to commit and the resources to follow through, it takes only one such market participant who is not risk averse to establish an observable fair value that includes no market risk premium (and may even include a market risk discount). One need look no further than the U.S. stock market during the period that it was being driven by what Alan Greenspan described as "irrational exuberance" to see markets are not always risk averse. Yet throughout the last half of the 1990s and the early 2000s, observed market transactions were used to establish fair values that could not have been supported by a discounted cash flow analysis that incorporated a significant market risk premium.

Furthermore, we do not believe it is true that all market participants faced with the choice described in paragraph 66 of CON 7 and summarized in paragraph A7 would always value the uncertain choice somewhere below the risk-free choice. Market participants that are risk neutral
or risk seeking actually would pay an equal or higher price in order to avail themselves of the opportunity to receive more than the certain payoff. Those participants, rather than the risk averse majority of market participants who choose to drop out of the bidding at an earlier stage, determine the fair value of an asset or liability with uncertain cash flows in at least some markets at least some of the time. In the final analysis, we believe that the presumption that the market is always risk averse because most of its participants are risk averse most of the time is precisely the sort of bias that is described in paragraph 96 of FASB Concepts Statement No. 2 and it should be removed from the final Statement (and from CON 7).

In addition to the theoretical concerns described above, at the practical level we are concerned that, despite the fact that professional valuation specialists historically have not incorporated independently estimated market risk premiums into their discounted cash flow valuations, unless the Board revises the discussion of market risk premiums in its final Statement along the lines we recommend, they will find themselves being compelled by auditors and/or regulators to include explicit risk premium adjustments into future fair value measurements based on discounted cash flows even though such adjustments cannot be supported by objectively verifiable data, making them inherently unauditable. In that regard, we share the concerns of Doug Carmichael expressed in his recent speech at Baruch College, and we do not believe such practice will result in improved fair value measurements or increased transparency in financial reporting. Therefore, we recommend the Board deal with the subject of market risk premiums in its final Statement as follows:

1. Consistent with the principle that fair value estimates should incorporate assumptions that market participants would use in valuing an uncertain cash flow stream, we believe that market risk premiums (or discounts) that are embedded in observable market parameters used in common valuation practice such as market yields and price/earnings or revenue multiples should be incorporated into discounted cash flow estimates of fair value without adjustment, even though they cannot be identified or verified independently of the parameter in which they are embedded.

2. In all other situations, discounted cash flow estimates of fair value should be based upon a presumption that the market is risk-neutral (i.e., that the market, as opposed to some of its individual participants, would neither charge a premium nor pay a premium in order to acquire the probability-weighted expected value of an uncertain stream of cash flows) unless that presumption can be overcome by substantial evidence that is both persuasive and objectively verifiable. When the presumption cannot be overcome, consistent with the guidance in paragraph 62 of CON 7, the expected cash flows should be discounted using a risk-free discount rate.

We believe such an approach is entirely consistent with the cautionary language found in CON 7 with respect to market risk premiums and that it will address concerns about the reliability and auditability of estimates for which there is little or no supporting evidence while preserving the basic principle that the market’s attitude towards risk should be included in a fair value measurement based upon discounted cash flows whenever it can be identified and measured reliably.
Issue 3: This proposed Statement would clarify that valuation techniques used to estimate fair value should emphasize market inputs, including those derived from active markets. In this proposed Statement, active markets are those in which quoted prices are readily and regularly available; readily available means that pricing information is currently accessible and regularly available means that transactions occur with sufficient frequency to provide pricing information on an ongoing basis. Is that guidance sufficient? If not, what additional guidance is needed?

If prices in active markets are readily and regularly available, we agree that they should be used, at least to the extent that the subject asset (liability) is closely comparable. Inasmuch as this is a basic principle, we do not believe further rules on how to determine active markets is necessary.

Issue 4: This proposed Statement would provide general guidance for selecting the valuation premise that should be used for estimates of fair value. Appendix B illustrates the application of that guidance (Example 3). Is that guidance sufficient? If not, what additional guidance is needed?

The concepts of value in-use and value in-exchange are thoroughly understood by valuation practitioners, and the Board is correct in the distinctions made in the ED. However, because this represents a dramatic change in practice, we believe additional principles-based guidance is necessary as to when market participant considerations must be included. (Also see our comments below on the examples in Appendix B.)

Issue 5: This proposed Statement would establish a hierarchy for selecting the inputs that should be used in valuation techniques used to estimate fair value. Those inputs differ depending on whether assets and liabilities are identical, similar, or otherwise comparable. Appendix B provides general guidance for making those assessments (Example 4). Is that guidance sufficient? If not, what additional guidance is needed?

We do not believe a hierarchy for selecting the inputs used in valuation techniques is necessary. While we agree that fair value should be estimated using quoted prices for identical assets or liabilities in active reference markets whenever that information is available (Level 1), we are not aware of any assets that fit into Level 2. We believe a more appropriate approach would be to state that the objective is to utilize all the applicable valuation approaches that can reasonably be expected to yield results consistent with the objective of fair value. The selection of the specific valuation approach or approaches should be a professional judgment concerning what is likely to produce the most relevant and reliable measurement, taking into account the facts and circumstances, including the availability of objectively verifiable data needed to apply the approach. Forcing a hierarchy appears to be a rules-based solution to the fair value measurement principle that, in practice, may result in a failure to achieve the objective.

Issue 6: In this proposed Statement, the Level 1 reference market is the active market to which an entity has immediate access or, if the entity has immediate access to
multiple active markets, the most advantageous market. Appendix B provides general guidance for selecting the appropriate reference market (Example 5). Is that guidance sufficient? If not, what additional guidance is needed?

We believe that the guidance about most advantageous market is confusing as it relates to transportation costs. We do not understand whether the Board believes transportation costs are a form of transaction costs and, if so, how that relates to the idea of immediate access in paragraph 16 and the comment in paragraph 23.f. that a price might need to be adjusted for differences in location.

Consider the following example, which is adapted from Example 5 in Appendix B. An enterprise owns grain that it can sell either to the local grain elevator or to the grain market in Chicago. The price at the local grain elevator is $25 per bushel, with transportation costs of $5 per bushel. The price in Chicago is $35 per bushel, with transportation costs of $13 per bushel. Chicago is the more advantageous market, because the enterprise will net $22 per bushel versus $20 per bushel at the local grain elevator.

If transportation costs are a form of transaction cost, then Example 5 in Appendix B states that the fair value of the grain is $35 per bushel. The Committee does not agree with that result, because it believes that $35 is, in fact, in excess of the fair value of the grain in its current location. However, the Committee is uncertain whether $35 per bushel is the intended result. Does the enterprise have immediate access to the market in Chicago if it would take a week to transport the grain to Chicago? More significantly, would paragraph 23.f. require that the $35 per bushel price in Chicago be adjusted for the fact that the grain isn’t in Chicago? If so, how would transportation costs enter into the adjustment for location?

Issue 7: This proposed Statement would require that the fair value of financial instruments traded in active dealer markets where bid and asked prices are more readily and regularly available than closing prices be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities), except as otherwise specified for offsetting positions. Do you agree? If not, what alternative approaches should the Board consider?

We believe that, rather than prescribing a specific approach in this case, the Board should allow companies to adopt a policy that reflects their specific market practices. Some entities have indicated the majority of their transactions do not occur at the bid or the ask price — but at a midpoint. Importantly, this also reflects current practice for valuation purposes. We do not believe the Board has demonstrated why a change such as that proposed by the ED is required or represents an improvement to current practice. In this context (like much of the ED) the focus is on financial instruments. There is no discussion of real estate or other non-financial assets, for which market practices could warrant a different approach to most representationally reflect fair value. To ensure the final guidance achieves the intended objective, is appropriate across multiple assets, and can be adopted in a way that conforms to an entity’s market practices, we believe the Board should not require a specific approach to bid-ask spreads.
Issue 8: For unrestricted securities with quoted prices in active markets, many FASB pronouncements (including FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments) require that fair value be estimated as the product of a quoted price for an individual trading unit times the quantity held. In all cases, the unit of account is the individual trading unit. For large positions of such securities (blocks) held by broker-dealers and certain investment companies, the AICPA Audit and Accounting Guides for those industries (the Guides) permit fair value to be estimated using blockage factors (adjustments to quoted prices) in limited circumstances. In those cases, the unit of account is a block.

The Board initially decided to address that inconsistency in this proposed Statement as it relates to broker-dealers and investment companies. The Board agreed that the threshold issue is one of determining the appropriate unit of account. However, the Board disagreed on whether the appropriate unit of account is the individual trading unit (requiring the use of quoted prices) or a block (permitting the use of blockage factors). The majority of the Board believes that the appropriate unit of account is a block. However, the Board was unable to define that unit or otherwise establish a threshold criterion for determining when a block exists as a basis for using a blockage factor. The Board subsequently decided that for measurement of blocks held by broker-dealers and certain investment companies, current practice as permitted under the Guides should remain unchanged until such time as the Board fully considers those issues.

For those measurements, do you agree with the Board's decision? If applicable, what approaches should the Board consider for defining a block? What, if any, additional guidance is needed for measuring a block?

First, we believe the guidance on large positions of securities should be uniform across all industries – not limited to special guidance for broker-dealers and investment companies. Additionally, consistent with the ED objective of determining fair value, we believe it is necessary to acknowledge that if an entity holds a large block of a security, the fair value of that asset may be different than (unit price * quantity), because at some point the market price is impacted by the size of the block, which could result in either a premium or a discount. While we understand there may be concerns about whether management will express a different intent for valuation than may ultimately occur in practice (e.g., use a block approach for valuation and then proceed to sell the securities in smaller traunches or vice versa), we do not believe the Board can or should attempt to establish accounting rules that would prevent unscrupulous management from taking advantage of a misrepresentation of its intentions, but only at the expense of reporting as fair value an amount that clearly does not satisfy the definition of fair value except at the unit level. In that regard, we do not find the unit of account argument to provide a persuasive basis for representing as fair value amounts that quite clearly could not be realized in the marketplace under normal or expected trading conditions. Accordingly, we believe the Board should simply maintain the principle that available valuation techniques and market inputs should be used, with an acknowledgement that in certain cases fair value may be impacted by the size of the position. Specific examples could be provided to ensure the objective and application of this guidance is adequately conveyed.
Issue 9: This proposed Statement would require that in the absence of quoted prices for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach, and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort (Level 3 estimates). Appendix B provides general guidance for applying multiple valuation techniques (Examples 6–8). Is that guidance sufficient? If not, what additional guidance is needed?

We believe this is another instance where principles are better than rules. Professional valuation specialists may use multiple valuation techniques as appropriate for a particular situation, with an analysis of the correlation of the results, as required by generally accepted valuation principles. We believe such an approach is appropriate in many cases as part of the process to determine fair value. However, we would not mandate use of all approaches, since that would ignore the potential cost and relevance of certain methods in certain situations. Rather, we would reiterate the principle of estimating fair value and the need to consider multiple approaches in estimating the most appropriate amount.

Issue 10: This proposed Statement would require that the fair value of restricted securities be estimated using the quoted price of an otherwise identical unrestricted security, adjusted for the effect of the restriction. Appendix B provides general guidance for developing those estimates, which incorporates the relevant guidance in SEC ASR No. 113, Statement Regarding “Restricted Securities.” Is that guidance sufficient? If not, what additional guidance is needed?

We do not believe the guidance is sufficient. Although paragraph B17 provides guidance on what factors may be relevant to determining the value of a restriction, that guidance is too general to be applied consistently in practice. Further, the guidance incorporated into paragraph B18 of the ED is of limited assistance because it only tells practitioners what not to do in determining the fair value of a restricted security. An illustration of how the factors suggested in paragraph B17 would be used to determine the value of a restriction would be more helpful than the recitation of proscriptions contained in paragraph B18.

We believe the discussion of restricted securities should also address whether studies on the effects of restrictions on the fair value of a security should be considered and, if so, how. We are aware of many studies of restricted securities, but their conclusions seem to be of limited assistance in determining the value of a restriction on any particular security because of differences both among and within the studies.

Issue 11: This proposed Statement would require expanded disclosures about the use of fair value to remeasure assets and liabilities recognized in the statement of financial position. Appendix B illustrates those disclosures. This proposed Statement also would encourage disclosures about other similar remeasurements that, like fair value, represent current amounts. The Board concluded that those disclosures would improve the quality of information provided to users of financial statements. Do you agree? If not, why not?
We are concerned about the ever-increasing amount of "compliance" disclosures being required. In this case, in particular, it appears these represent additional disclosures being "layered on" to the existing requirements under the standards that require fair value measures. There also is the sense that more extensive disclosures are required to supplement a fair value measure that may not be well accepted, understood — or even "trusted". We believe a better approach would be to re-evaluate existing disclosures requirements and develop a disclosure framework that could be applied more holistically. Such a framework might differentiate between information needs associated with recurring fair value measures versus those associated with occasional fair value measures. Not surprisingly, we believe such a disclosure framework would best be developed after adequate study of user needs regarding fair value information.

**Issue 12:** This proposed Statement would be effective for financial statements issued for fiscal years beginning after June 15, 2005, and interim periods within those fiscal years. The Board believes that the effective date provides sufficient time for entities to make the changes necessary to implement this proposed Statement. Do you agree? If not, please explain the types of changes that would be required and indicate the additional time that would be needed to make those changes.

We believe the pervasiveness of the applicability of this ED may require companies to invest some amount of time to fully understand its implications and implement necessary process changes. As a rule of thumb, we believe such changes should allow for approximately one year from issuance to the effective date. Additionally, we believe it may be beneficial to understand how the ED interacts with the business combination phase 2 project. Prior to finalizing the proposed standard, it may be prudent to test the operationality with the requirements of FASB Statement No. 142 and the new 141.

**Issue 13:** This proposed Statement represents the completion of the initial phase of this project. In subsequent phases, the Board expects to address other issues, including issues relating to the relevance and reliability of fair value measurements and the unit of account that should be used for those measurements. What, if any, other issues should the Board address? How should the Board prioritize those issues?

As indicated in our cover letter, we believe there remain significant questions on the relevance and reliability of fair value information. We encourage the Board to consider an Invitation to Comment on the broader issues to gain more input before proceeding with development of an exposure draft. Importantly, we encourage the Board and staff to obtain more current research on the use of fair value in the financial statements. While such information might be useful...is it relevant as the primary attribute for measuring the performance of an entity? Is it the preferable measure for assets and liabilities that cannot or will not be sold, settled or exchanged? How will the information be used in decision making? What supplemental information would be necessary to increase its usefulness or relevance? As indicated, we believe it is important to resolve such issues before proceeding to finalize a standard on measurement of fair value. We believe this work should be undertaken in a comprehensive way -- we do not believe that the
issue of relevance, from the perspective of financial statement users, can be ascertained reliably or credibly from an anecdotal poll of the members of the recently convened User Advisory Council.

Our views on the examples in Appendix B follow.

Example 1. [B3] The ED states that "... the "winning" bid would include a premium over the other bids. That premium would not necessarily reflect the value of the synergies. Rather that premium would reflect the amount that the particular buyer is willing to pay over the other bids to acquire those synergies." These statements appear to be inherently in conflict with one another. If the amount of the final bid includes synergies that benefit the buyer, then why is the winning bid not reflective of the value of the synergies?

Some readers have interpreted this conclusion to mean that fair value based on a market participant's view does not equate to the winning bid. Rather it must be reflective of the losing bid because that is the only other market participant left. If that were the view, it would appear that there must be an immediate impairment recognized in the period of acquisition. If that is not the Board's intention, we would recommend that this concept be explained more clearly in the final Standard.

Example 2. [B5] Please indicate that the example relates only to the unit of account and is not dispositive of how to value customer relationships. Otherwise auditors will refer to this portion of the Standard and not allow customer relationships to be valued individually, even though that may be appropriate.

Example 3. [B7] Valuation practice has been to value Machinery and Equipment (M&E) in a purchase price allocation based on replacement-cost, adjusted for physical, functional and economic depreciation. The efficacy of those values is then tested by obtaining transaction prices from the used-equipment market for certain large items. It is impractical to attempt to go to the market and obtain dealer prices for every piece of equipment, large and small, in a facility. It would be quite helpful if the final Standard addressed whether or not a target company's own fixed asset record, (date of acquisition and original cost) can in practice be trended through the use of appropriate cost indexes. If the Board truly means for all M&E allocations to be based on market participants, i.e., used equipment dealers, this should be made clear because the cost implications to buyers will be very significant. In the absence of guidance, auditors and regulators are likely to require this type of valuation for all of the acquired M&E at tremendous costs to the acquiror while providing small improvements in the relevance or reliability of the measurement.

Example 5. [B9] We believe that the guidance on how to select the active market to which an entity has access needs to be clarified. While the guidance is relatively clear for cases in which
access to one market is precluded (e.g., because its trading consists of portfolios), it is less clear how one would select a market when the entity could trade in all three markets. For example, assume that a real estate developer is in the business of buying and selling residential development tracts. It has acquired a major tract and has subdivided it and begins to sell some of the individual lots in the retail market. Should the land be valued at the number of lots times the unit price, or at what a builder or another developer would pay for the tract of subdivided lots? Both are relevant markets. Would the selection of markets change if no lots had been sold individually and the developer was holding the tract for sale to builders as a subdivision?

Example 6. [B12] We do not understand how this example relates to Example 3. Here a market and a cost approach are considered for allocation of purchase price for M&E. The market approach values (based on market prices for used equipment) are chosen because “... they require fewer and less subjective adjustments for differences.” We do not see how a valuation specialist will be able to determine the required adjustments for condition from prices quoted by dealers and at auction. In practice, the appraiser sees the equipment on the factory floor and makes all necessary adjustments on location. Without an extraordinary amount of travel to dealers (note that dealers specialize by type of asset, not by industry in which the assets are used) we do not see how can one make appropriate adjustments for age, condition and functional obsolescence. We know from experience that it is not realistic to do this by teleconference, and the economics of traveling are equally unrealistic. Moreover, example 6 starts with an incorrect premise – that dealer prices for used equipment are going to be better, more relevant and reliable, than indexed original cost. To the best of our knowledge, auditors and regulators have never challenged allocations of purchase price for M&E as performed under both APB 16 and SFAS 141. Nearly all of those allocations used the cost approach as the basis, substantiated by testing certain major items in the market. The Board should reconsider the basis for the answer provided and explain why such a major change in practice is beneficial.

Example 7. [B14] This example appears to set out the income approach to valuing revenue-producing software as the preferred method, and to discount the cost approach on the grounds that it is hard to estimate indirect costs. Our experience does not support the Board’s assumption that it is difficult to obtain relevant and reliable costs. Moreover, the preferred methodology will probably overstate the FV of software, leading to future impairment charges. In the example, we do not accept the presumption that a “market participant” would pay $15 million on a cost or value buildup in determining the FV of the business as a whole. Again, the Board appears to have a bias against the cost approach. The absence of balance in the choice of methods in these examples will make it hard for valuation specialists to use cost-based values even in circumstances where they represent the best available measure. We firmly believe that the Board needs to obtain better information about what valuation specialists use and translate that into more balanced examples that better reflect current practices.