April 10, 2006

Technical Director
File Reference No. 1250-001
Financial Accounting Standards Board
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Norwalk, CT 06856-5116


We appreciate the opportunity to respond to the proposed Statement, The Fair Value Option for Financial Assets and Financial Liabilities. We agree with the Board’s stated objective of establishing standards to require reporting financial assets and financial liabilities at fair value in the financial statements. We believe that this proposal represents an important step towards achieving that objective. The proposed Statement would enable entities to report in earnings the offsetting effects of changes in the fair values of related assets and liabilities without being required to apply the often complex requirements for fair value hedge accounting set forth in FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities. Reporting financial instruments at fair value would also eliminate the need to identify and separate embedded derivatives, which would further simplify financial reporting.

While we believe the proposed Statement will reduce complexity associated with the current mixed attribute model, accounting for financial assets and liabilities at fair value will create other challenges. For example, interpretative guidance on the application of fair value measurement techniques to certain financial assets and liabilities may be necessary and the Board should begin to develop its procedures and processes for addressing those issues.

While we acknowledge that the proposed Statement may impact consistency and comparability in the near term because it permits a treatment alternative, we believe the proposed Statement is an appropriate intermediate step that will provide the Board and its constituents with experience and information that will help resolve practical issues relating to fair value measurement and display as the Board progresses towards its ultimate objective. Additionally, the potential impact on consistency and
comparability that may arise as a consequence of the proposed Statement can be mitigated with robust disclosures by entities that elect fair value measurement for certain contracts. While we support the issuance of the proposed Statement, we do note some aspects of the proposal where additional clarity would be helpful. Our specific comments on the proposed Statement are set forth below.

Scope

Investments Accounted for under the Equity Method

We agree with the Board’s decision to provide the fair value option for investments accounted for under the equity method. However, we believe there are a number of issues that should be addressed to improve consistency in the application of this guidance for entities that elect the fair value option for investments that would otherwise be accounted for under the equity method.

The proposed Statement would permit entities to elect fair value measurement for financial assets and financial liabilities on a contract-by-contract basis. For purposes of applying this guidance to investments in equity securities, the Board should clarify whether the contract is an individual equity share, whether it is all equity shares of the investee in a particular class (e.g., Class A common stock) that are held by the investor, or whether it is all equity shares and other securities of the investee that are held by the investor. In order to avoid the complexities related to the interaction of the equity method with the accounting for investments in other securities of the investee, we believe that the fair value measurement election should be applied to both the investment that would otherwise be accounted for under the equity method and other securities of the investee held by the investor.

The Board should also specifically address whether the change from a cost method investment to an equity method investment is a remeasurement event that would allow an investor to elect the fair value measurement option at that time. As currently written, it appears the change from a cost method investment to an equity method investment would not qualify as a remeasurement event. However, we believe that the Board should allow investors to make the fair value measurement election for all securities of the investee upon obtaining significant influence.

Definition of Contract

In addition to the issues related to investments accounted for under the equity method discussed above, we believe additional guidance in the proposed Statement about how the definition of a contract should be applied will improve consistency in its application.
For example, an entity issues a $100 million bond obligation. If the entity elects the fair value measurement for the bonds, may it elect fair value measurement for a portion of the bonds and, if it may elect fair value for a portion of the bonds, would it be required to specify which bonds it is designating?

**Warranty Obligations and Rights**

Warranty obligations and rights that are financial liabilities or financial assets would be eligible for the fair value measurement election under the proposed Statement. To ensure consistency in application, the proposed Statement should clarify the types of warranties that would be considered financial liabilities and financial assets. Based on the definitions of *financial liability* and *financial asset* in the proposed Statement, it appears that a product warranty that may require the issuer of the warranty to make payment in either services (e.g., product repair services) or cash would not be a financial asset or financial liability within the scope of the proposed Statement. However, it appears that a product warranty that would require the issuer of the warranty to make payment only in cash is a financial liability for the issuer and a financial asset for the recipient once it has been recognized.

Some warranty obligations may not be accounted for on a contract-by-contract basis. Under FASB Statement No. 5, *Accounting for Contingencies*, entities may apply the conditions for liability recognition to groups of warranties entered into in conjunction with similar types of sales transactions (i.e., rather than on a contract-by-contract basis). We believe the fair value measurement option would only apply to warranty obligations for which the election is made on a contract-by-contract basis at initial recognition of the obligation. Therefore, the election can not be made for a previously recognized group of warranties. The Board should clarify that issue in the final Statement.

In circumstances where a separately priced extended warranty obligation constitutes a financial liability, the proposed Statement should specify the manner in which the fair value measurement election should be applied. We believe a vendor would initially separate the separately priced extended warranty from other deliverables based on the stated amount of the extended coverage pursuant to FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*, and would then immediately adjust the carrying amount of the warranty obligation to its fair value, with the difference recognized in earnings. If the Board believes another method of applying the fair value measurement election to a separately priced extended warranty obligation is appropriate, the final Statement should clarify how
the resulting separation from other deliverables interacts with the guidance in EITF Issue No. 00-21, “Revenue Arrangements with Multiple Deliverables.”

**Written Loan Commitments**

We believe written loan commitments that are not accounted for as derivative instruments should be eligible for the fair value measurement election. Paragraph A(6) of the proposed Statement indicates that such written loan commitments will be addressed in Phase 2 of the fair value option project because nonfinancial components affect the determination of the fair value of those items. However, nonfinancial components also affect the determination of the fair value of written loan commitments that are accounted for as derivatives, as well as other financial assets and liabilities within the scope of the proposed Statement. The exclusion of written loan commitments from the scope of the proposed Statement also creates differences between the fair value option in the proposed Statement and International Accounting Standard 39, *Financial Instruments: Recognition and Measurement.*

Furthermore, we understand that the scope exception in paragraph 10(i) of Statement 133 for certain loan commitments was provided as a practical expedient to address whether the underlying loans would be considered readily convertible to cash, rather than for conceptual purposes. As such, it is not clear why this distinction should be perpetuated for purposes of determining the scope of the proposed Statement.

**Financial Liabilities and Financial Assets Recognized under Lease Contracts**

We agree that the requirements for measuring a lessee’s obligation under a capital lease should be addressed as part of a comprehensive reconsideration of FASB Statement No. 13, *Accounting for Leases,* and, accordingly, should not be included within the scope of the fair value option project. Accordingly, we support the scope exception in the proposed Statement for those financial liabilities. However, we believe paragraph 4(c) should also contain an explicit scope exception for the assets recognized by lessors under sales-type leases, direct financing leases, or leveraged leases.

**Changes in Creditworthiness**

As we have expressed in previous comment letters to the Board, we question the usefulness of reporting changes in fair values of liabilities resulting from changes in the issuer’s own creditworthiness in the financial statements, particularly under the fair value option in the proposed Statement because fair value will not be required for all financial assets and financial liabilities nor permitted for non-financial assets and non-financial liabilities. Accordingly, we share the concerns expressed by certain Board members as described in paragraph A11 of the proposed Statement. In addition, if the Board permits
entities to recognize such changes, we do not believe that the qualitative disclosures proposed by paragraph 12(c) of the proposed Statement alone are adequate to ensure that users will have the information to understand how the fair value measurement of certain financial liabilities is impacting an entity's financial statements. Therefore, in addition to those qualitative disclosures, we believe the proposed Statement should require quantitative disclosure of changes in fair value, during the period and cumulatively, that are attributable to changes in the entity's own credit risk for financial liabilities for which fair value measurement has been elected. This additional disclosure requirement would also increase the comparability between the fair value option in the proposed Statement and IAS 39.

Presentation and Disclosure Requirements

Cash Flows Statement

The proposed Statement would require that cash receipts and payments related to financial assets and financial liabilities for which fair value measurement has been elected be classified in the statement of cash flows based on the nature and purpose for which the related financial assets and financial liabilities were acquired or incurred. It is not clear from that guidance how cash flows should be classified for financial assets and financial liabilities that are intended to economically hedge other financial instruments.

Methodology Used to Estimate Fair Value

Similar to the guidance contained in FASB Statement No. 156, Accounting for Servicing of Financial Assets, we believe entities should be required to disclose the valuation methodology used to estimate the fair value of financial assets and financial liabilities for which fair value measurement has been elected. If a valuation model is used, that description should include the methodology and model validation procedures, as well as quantitative and qualitative information about the assumptions used in the model.

Not-for-Profit Organizations

The Board should clarify where a not-for-profit organization that presents an intermediate measure of operations (a performance indicator) should present changes in fair values of financial assets and financial liabilities for which the fair value measurement option has been elected.

Presentation Requirements and Illustrative Examples

The proposed Statement provides guidance on the presentation in the statement of financial position of financial assets and financial liabilities that are measured at fair value pursuant to the fair value measurement option. We believe guidance should also be provided for presentation in an entity's statement of operations of changes in the fair values of financial assets and financial liabilities that are measured at fair value under the proposed Statement. Additionally, illustrative examples of presentation in the financial
statements would be useful to preparers and could mitigate the potential impact on consistency and comparability from applying the fair value measurement election. Until such time as the IASB and FASB have completed their joint project on Financial Performance Reporting by Business Enterprises, we believe such financial statement presentation guidance is an important element in order to progress toward the goal of reporting all financial assets and financial liabilities at fair value.

Other Items

Definitions of ‘Financial Asset’ and ‘Financial Liability’

The definition of financial instrument in FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, Statement 133, and FASB Statement No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity, contains footnotes which clarify that (1) contractual rights and obligations encompass conditional rights and obligations and (2) any number of obligations to deliver financial instruments can be links in a chain that qualifies a particular contract as a financial instrument. These footnotes have been omitted from the definitions of financial asset and financial liability in the proposed Statement and we suggest that they be included to ensure that consistent definitions are used when applying these respective standards.

Unit of Measurement

We believe the proposed Statement should clarify that, although fair value measurement must be elected on a contract-by-contract basis, it does not provide any guidance on the measurement of financial assets and financial liabilities for which fair value measurement has been elected. For example, if fair value measurement is elected for each contract in a homogenous loan portfolio, the proposed Statement does not address whether the measurement should be based on the fair value of the entire loan portfolio or the fair value of each individual loan. To avoid confusion, the proposed Statement should explicitly indicate that it does not require entities to measure fair values on a contract-by-contract basis in all circumstances (i.e., the methodology for measuring fair value is not within its scope).

Partial and Step Acquisitions

The proposed Statement permits an entity to elect fair value measurement when a financial liability is initially recognized or upon an event that gives rise to a new-basis of accounting at fair value. A new-basis event is identified as an event, other than the recognition of an other-than-temporary impairment charge, that requires a financial instrument to be remeasured to its fair value at the time of the event but does not require that instrument to be reported at fair value on a continuous basis. One example of a remeasurement event that is specified in the proposed Statement is a business combination accounted for under FASB Statement No. 141, Business Combinations. In a
partial or step acquisition, the values assigned to assets acquired and liabilities assumed are based on their fair values to the extent of the ownership interest acquired. The remaining portion of the values assigned to the assets and liabilities of the acquired enterprise is based on the historical financial statement carrying amounts of the acquired enterprise. Based on the guidance in paragraph 9 of the proposed Statement, it appears that an entity would be allowed to apply the fair value measurement option to financial assets and financial liabilities acquired in a partial acquisition when the acquired company is first consolidated with the entity but would not be allowed to elect the fair value measurement option upon subsequent acquisitions of minority interests. We agree with that guidance. However, the Board should make that clear in the final Statement.

**Impact on Statement 155**

FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, amends paragraph 16 of Statement 133 to permit an entity to elect fair value measurement for certain hybrid financial instruments that contain an embedded derivative that would otherwise require separation from the host contract. It appears that the issuance of the proposed Statement may obviate the need for that guidance. In the interest of simplifying the existing authoritative literature, the Board should consider whether those particular changes to Statement 133 that resulted from the issuance of Statement 155 should be nullified.

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If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419, Enrique Tejerina at (212) 909-5530, or Paul Laurenzano at (212) 909-5825.

Sincerely,

KPMG LLP