April 10, 2006

Mr. Lawrence W. Smith
Director—Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116


Dear Mr. Smith:

Goldman Sachs appreciates the opportunity to comment on the Financial Accounting Standards Board’s Exposure Draft, The Fair Value Option for Financial Assets and Liabilities (the “ED”). We fully support the Board in its effort to broaden the application of fair value measurement in accounting for financial instruments and encourage the Board to move expeditiously to issue a final Statement.

We believe the Board’s decision to permit the use of the fair value attribute for measuring financial instruments in the financial statements is a significant improvement to the financial reporting framework. Fair value is the most relevant measure for financial instruments. It reduces the need for exception based accounting, such as hedging, to counteract differences caused by a mixed attribute framework, and it better aligns financial reporting with how most entities manage risk. We acknowledge that the ability to elect fair value treatment may contribute to reduced comparability among issuers of financial statements. However, the advantages of recording financial instruments at fair value significantly outweigh this potential reduction in comparability. We believe that the issues surrounding comparability can be addressed through disclosures and will lessen over time as market demand leads to greater acceptance and reporting of fair value information.
Written Loan Commitments

We believe all written loan commitments should be included in the final Statement and valued solely on their contractual terms.

We recognize written loan commitments are excluded from the scope of the ED because the Board believes the determination of their fair values involves consideration of nonfinancial components. While some believe nonfinancial components are present in mortgage loan commitments (because a servicing asset may contractually arise if the borrower exercises the commitment), we believe they clearly are not a significant issue for commercial loan commitments. For example, if a lender under-prices a large commercial loan commitment to a corporate borrower because the lender expects it may lead to future business, the economic loss suffered by the lender from that under-pricing should be recognized in current earnings. In our view, not recognizing that loss on the basis that a customer relationship intangible has been created is equivalent to recognizing revenue in advance of when it is earned, in contradiction of long-standing revenue recognition principles. If the Board believes it would be inappropriate to include all written loan commitments in the final Statement, then the scope of the final Statement should, at a minimum, include commercial loan commitments. In our view, this is a practical delineation the Board can and should make.

Physical Commodities and Non-derivative Energy Contracts

We recognize nonfinancial instruments will be addressed in Phase 2 of the fair value option project. We are concerned that Phase 2 may take considerable time to finish because of the diverse nature and complexity of the remaining issues. We encourage the Board to separate Phase 2 into sub-phases and prioritize work on the basis of highest incremental return relative to costs to complete.

One group of nonfinancial instruments we believe should be a high priority is physical commodities and non-derivative energy contracts, such as transportation and transmission contracts, natural gas storage contracts, emission allowances and certificates, and tolling arrangements, including those that may be deemed to be leases under EITF Issue 01-8. This group of instruments is often risk managed at fair value by a broad array of market participants, including both financial and nonfinancial institutions.

These instruments can suffer the earnings mismatch of the mixed attribute accounting model because they often are entered into in combination with other instruments accounted for at fair value. The mismatch can be significant for some companies depending on the volatility of commodities markets. This earnings mismatch can have indirect effects as well, as companies that are not willing to bear the mismatch elect not to bid on transactions, reducing competition. Hedge accounting is generally unavailable because its requirements are difficult to meet and burdensome to apply. In short, these instruments are prime candidates for the fair value option because they meet all of the
reasons for permitting the option articulated by the Board in paragraph A3 of the ED. We urge the Board to move quickly in this area.

Transition

We disagree with the transition provisions in paragraph 14 of the ED. The very premise of the ED is that fair value is the best measure for financial instruments, and changes in that measurement should be included in income. We believe the move from a different measurement attribute to fair value is an improvement in financial reporting, and the change in valuation is a real component of earnings that properly belongs in the income statement. We are concerned that a requirement to record the effect of initial adoption in retained earnings will discourage issuers from designating existing financial assets and liabilities, and will therefore perpetuate differences and exacerbate lack of comparability in financial statements. Moreover, it could encourage entities to include in their transition adjustment, instruments with unrealized losses that are expected to reverse. The loss at transition would be included in retained earnings while any reversal would be included in subsequent earnings. We strongly encourage the Board to reconsider the transition provisions and to require an approach utilizing a cumulative effect recognized in income in the year of adoption.

We have provided responses to the specific questions set forth in the ED (Notice to Recipients) in the attached Appendix to this letter.

Thank you for the opportunity to present our views.

Sincerely,

Matt Schroeder
Scope

**Issue 1:** The scope of this proposed Statement includes the following financial assets and financial liabilities that some may not have considered as being included:

a. An investment being accounted for under the equity method
b. Investments in equity securities that do not have readily determinable fair values, as described in paragraph 3 of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
c. Insurance and reinsurance contracts that are financial instruments, as discussed in FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*, No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, and No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*
d. Warranty obligations that are financial liabilities and warranty rights that are financial assets
e. Unconditional purchase obligations that are recorded as financial liabilities on the purchaser’s statement of financial position as discussed in paragraph 10 of FASB Statement No. 47, *Disclosure of Long-Term Obligations.*

**Question:** Should an entity not be permitted the option to initially and subsequently measure those financial assets and financial liabilities or any others at fair value? If so, why should those financial assets and financial liabilities be excluded from the scope of this proposed Statement?

**Response:** Goldman Sachs supports entities being permitted the option to initially and subsequently measure those financial assets and financial liabilities listed above at fair value. We are not aware of any additional financial assets or liabilities that should be added to the scope exclusion.

**Issue 2:** This proposed Statement permits an entity to elect the fair value option at inception for a firm commitment that would otherwise not be recognized at inception under existing generally accepted accounting principles (GAAP) and involves only financial instruments.

**Question:** Should an entity be permitted the option to recognize those firm commitments at fair value at inception of the contract? If so, why is the availability of
the fair value option election important for those contracts and what types of entities would likely avail themselves of that fair value option election? Should the scope be limited to forward contracts that meet the definition of firm commitments under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (that is, requiring that the terms of the forward contract include a disincentive for nonperformance that is sufficiently large to make performance probable)? If not, why not?

Response: Yes, Goldman Sachs supports entities being permitted the option to recognize firm commitments (as defined in FASB Statement No. 133) involving only financial instruments at fair value. We believe that fair value is a more relevant measure of a firm commitment involving financial instruments than cost (which is usually zero). In addition, we support permitting the broad use of the fair value option across financial instruments, including firm commitments, to enable entities to effectively manage potential non-economic accounting mismatches that might otherwise result from using mixed attributes.

Issue 3: The scope of this proposed Statement would exclude both (a) written loan commitments that are not accounted for as derivative instruments under Statement 133 and (b) financial liabilities for demand deposit accounts. The Board decided to specifically exclude those financial instruments, since the determination of their fair values involves consideration of nonfinancial components.

Question: Should an entity be permitted the fair value option election for those financial instruments? If so, why? What would be the appropriate unit of account for determining the fair value of demand deposit liabilities? What other financial assets and financial liabilities for which their fair values involve consideration of nonfinancial components should be excluded from the scope of this proposed Statement?

Response: As previously stated in our letter, Goldman Sachs supports permitting the fair value option for all written loan commitments or, at a minimum, commercial loan commitments. In addition, as a matter of symmetry, we believe the lender and the borrower should value the commitment in the same manner, that is, based on the commitment’s contractual terms.

Issue 4: The scope of this proposed Statement would also exclude:

a. An investment that would otherwise be consolidated
b. Employers’ and plans’ financial obligations for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements as defined in FASB Statements No. 35, Accounting and Reporting by Defined Benefit Pension Plans, No. 87, Employers’ Accounting for Pensions, No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions,
c. Financial liabilities recognized under lease contracts as defined in FASB Statement No. 13, Accounting for Leases. (This exclusion does not include a contingent obligation arising out of a cancelled lease or a guarantee of a third-party lease obligation.)

The Board decided to specifically exclude those financial assets and financial liabilities from the scope of this proposed Statement, as the Board believes that any modifications to the accounting for such financial assets and financial liabilities should be part of a reconsideration of those areas and should not be affected by the fair value option.

Question: Should an entity be permitted the fair value option election for those financial statements? If so, why?

Response: We agree that (a) investments in entities that would otherwise be consolidated, (b) employers’ and plans’ obligations for items such as pensions and other post-retirement benefits, and (c) leases should be excluded from the scope of this ED, because they raise significant other issues. These matters require substantial study before making changes to the accounting, and we agree they should be addressed in separate projects. However, we believe that arrangements deemed to be leases under EITF Issue 01-8 are qualitatively different from traditional leases, and believe leases under Issue 01-8 should be a high priority for Phase 2. Addressing the particular matters these items raise would significantly delay Phase 1 and such a delay would not be in the best interest of preparers and users of financial statements.

Issue 5: As noted above, this proposed Statement represents Phase 1 of the fair value option project. Phase 2 will consider permitting the fair value option for selected nonfinancial assets and liabilities. The Board is seeking input on what nonfinancial instruments should be included in the scope of Phase 2. Please provide details of those nonfinancial instruments and why they should be eligible for the fair value option.

Question: How would applying the fair value option to those nonfinancial instruments (a) improve financial reporting, (b) mitigate problems for reported earnings caused by the mixed-attribute model, and (c) enable an entity to simplify its accounting methods? Is fair value information readily available for those nonfinancial instruments?

Response: Goldman Sachs supports the use of fair value accounting for all financial instruments with the change in fair value recognized in income. In our view, the election of the fair value option will better align financial reporting with risk management practices, simplify accounting currently required by FASB Statement
No. 133 and other FASB Statements, and provide more relevant information for users of financial statements.

In light of these benefits, we encourage the Board to consider separating Phase 2 of the project into sub-phases. As previously stated in our letter, the Board should permit a fair value option for physical commodities and non-derivative energy contracts.

We also believe the Board should consider extending the Fair Value Option to real estate held for investment purposes. We believe this would more appropriately reflect the way entities view and manage such assets, and would be a step towards convergence with International Financial Reporting Standards.

Changes in Creditworthiness

Issue 6: This proposed Statement would permit an entity to elect the fair value option for certain financial liabilities, including debt liabilities. Under this proposed Statement, an issuer who has elected the fair value option for its debt liabilities would report changes in fair value of those liabilities, including changes resulting from changes in that issuer’s own creditworthiness, as gains and losses in earnings. If significant changes in fair value of those liabilities occur during a period, qualitative disclosures about the nature of those changes would be required. The Board discussed several possible approaches for curtailing the debtor’s recognition of the portion of a liability’s changes in fair value that is attributable to changes in its own creditworthiness and determined not to provide any curtailment; instead, the Board decided that liabilities should be recorded at fair value when the fair value option has been elected with all changes in fair value recorded in earnings.

Question: Do you agree with the Board’s decision? If not, why not? What alternative approaches or additional disclosure requirements should the Board consider?

Response: Goldman Sachs supports the FASB’s decision to permit application of the fair value option to certain financial liabilities, including an entity’s own debt. We support the Board’s decision that an issuer’s own creditworthiness should be reflected in the fair value of liabilities with gains and losses recognized in earnings. In our view, the holders of an entity’s debt liabilities consider the entity’s creditworthiness in their evaluation of the fair value of the assets it holds. We do not believe it would be appropriate to consider creditworthiness in the determination of fair value by the holder of a financial instrument, but not by the issuer.