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committee on corporate reporting

September 17, 2004

Suzanne Q. 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 No. 1201-100

Dear Ms. Bielstein:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") wishes to share its views on the Financial Accounting Standards Board's (the "Board") Exposure Draft of a proposed Statement of Financial Accounting Standards, *Fair Value Measurements* (the "ED"). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI.

We believe it is a laudable goal for the Board to develop a framework that would increase consistency and comparability in fair value measurements for financial and nonfinancial assets and liabilities. However, a majority of our members feel strongly that before the Board proceeds with issuing guidance on how to measure fair value, it must first address the conceptual issues surrounding fair value as a measurement basis for accounting. They take exception to the Board's approach in recent years (as outlined in paragraph C12), of requiring fair value measurements on a "piecemeal" basis without addressing the fundamental conceptual issues surrounding fair value. As such, they believe that the Board must address the conceptual issues regarding fair value before it proceeds with issuing guidance on fair value measurements and with providing future guidance in separate projects that would require further fair value accounting. Below, we describe in more detail some of the more significant conceptual concerns regarding fair value.

Relevance and Reliability

As expected, our members have differing views on the relevancy and reliability of a fair value accounting framework because of the different industries they represent. Some members believe that fair value information is only relevant in limited circumstances, for example a financial institution's trading portfolio. Some believe that fair value is relevant when an entity risk manages its assets and liabilities on a fair value basis, while others believe fair value is the only relevant measurement basis for most financial instruments. Some members believe that a cost approach, or the lower of cost or market, continues to represent the appropriate recording of historical transactions and, that fair value is not appropriate for financial reporting as those values can become stale by the time financial statements are issued and could create volatility in a companies financial statements that is completely removed from a company's operations and cash flow.

With respect to relevance, there is also the question of intent. Specifically, if an entity does not have the intent or there is an inability to sell an asset or settle a liability, should fair value be mandated? While we understand the Board has made the distinction that fair value should be based on market determinations and not entity specific intent, as described in paragraph 5, it is unclear how this would result in relevant information to financial statement users. For example, the timing and method of disposal of an asset or settlement of a liability can have a significant effect on the value exchanged with third parties in the transaction. Furthermore, many believe that the Board's desire to achieve consistency, comparability, and reliability in fair value estimates will sacrifice the relevance of the information provided. For example, requiring the use of the most advantageous price may not provide relevant information to users of financial statements if that is not the market where the entity principally transacts. .

Many members are concerned with the reliability of fair value measurement for nonfinancial assets and liabilities where no objective market information exists and there is significant uncertainty regarding the timing and method of disposal or settlement. There is an assumption in the ED that all assets and liabilities can be measured at fair value based on a hypothetical transaction with a market participant. However, there is often a broad range of fair values that could be assigned to assets and liabilities classified in Level Three of the proposed hierarchy. Significant assumptions would have to be made, often based on information that is neither objective nor verifiable, to develop highly uncertain estimates of fair value because there is not a market for an asset or liability and thus determining a reliable fair value may not be possible (e.g., environmental liabilities certain intangible assets, or asset retirement obligations). For example, determining the fair value of insurance liabilities is difficult given the restriction on legal transferability and the uniqueness of these obligations. That is, negotiated insurance contracts between a buyer and seller are for many reasons non-transferable. In fact, the use of fair value for insurance products would in all likelihood result in less reliability and increased subjectivity given that there are no markets for trading insurance products, where reliable benchmarks and therefore objective evidence can be obtained.

We have previously provided many other specific fact patterns that demonstrate our concerns regarding the relevance and reliability of fair value as a measurement basis. For example, we have discussed these issues in depth with respect to asset retirement obligations in our comment letter responses to the ED that led to issuance of FAS 143, the proposed Interpretation of FAS 143, and our request that the Board reconsider that standard. These issues and concerns are substantive and important to preparers, auditors and users of financial statements. We believe the Board should not continue issuing new accounting standards that require fair value measurements until the Board addresses these conceptual issues in a comprehensive manner.

Unit of Account

We understand the Board has deferred addressing the issue of unit of account until Phase II of the fair value project. We agree this issue is complicated and that it will take a significant amount of time for the Board to fully deliberate the issue; however we do not believe that the Board could possibly provide guidance on how to measure fair value if it has not addressed the issue of what the unit of account is to be measured at fair value. This is a critical issue for both financial and nonfinancial instruments and as such, we believe the Board should consider this before finalizing the guidance in the ED. For example, we agree with the Board in its decision on block discounts as we believe that when an entity holds a large position of a security, the appropriate unit of account is the block. However, we do not believe it is appropriate to have an inconsistency in practice between entities that are subject to the Broker-Dealer and Investment Company audit guides and those that are not. Thus, we believe the Board must address this issue sooner rather than later in order to ensure consistency in application of the proposed guidance.

Operational Issues

For most companies, a great deal of time and effort will be needed to create systems to capture and monitor fair value information, including the cost of hiring valuation specialists on a periodic basis. Furthermore, an internal control structure would have to be developed to ensure the consistency of application of methodologies used to measure fair value. Certain segments of financial institutions (i.e., commercial and investment banks) have spent an enormous amount of time and money for the appropriate governance and internal control structure in place to ensure the consistent application of fair value. The Board should evaluate the costs associated with fair value measurements for all entities in conjunction with the issues noted above on relevancy and reliability to determine whether the benefits of a fair value accounting model outweighs the significant costs.

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As discussed above, we do not believe that the Board should move forward with this project until they have resolved the issues described above. If the Board decides to continue with this project before addressing the conceptual issues surrounding fair value described above, then we respectfully request the Board to consider the following specific comments on the ED.

- Active Markets - Use of Bid and Offer Prices
- Marking Liabilities for an Entity's Own Credit Spread
- Use of Multiple Valuation Techniques
- Disclosures

Active Markets- Use of Bid and Offer Prices

We do not believe that the Board should be prescriptive in mandating the use of bid prices for long positions and offer prices for short positions in active dealer markets. The ED proposes a definition of fair value as the price at which an asset or liability could be expected to be exchanged in a current transaction between knowledgeable, unrelated willing parties. We believe this definition is sufficient to ensure that the most appropriate price is chosen for fair value, which may be the bid and offer prices for assets and liabilities, respectively or it may be a price within the bid-offer range based on facts and circumstances. It should also be acceptable that closing prices be used to estimate the fair value of financial instruments traded in active dealer markets when they are available.

Also requiring the use of bid-offer to derivatives can cause unintended consequences in achieving hedge effectiveness for fair value hedges under SFAS 133. The fair value of the derivative will be impacted by not only changes in the benchmark rate, but also changes in the bid-offer spread (i.e., a widening or narrowing of the spread between the bid and offer price). Changes in the measurement between bid and offer prices will impact hedge effectiveness and thus may cause a hedge to become ineffective, even though the risk has been effectively offset as currently required by SFAS 133. We request that the Board consider this additional complication that will be added to hedge accounting if bid and offer prices are required in the final standard.

Furthermore, it is current practice for derivative dealers to mark derivative positions to the mid-market price, with appropriate adjustments made as necessary (e.g., credit and bid-offer). This is appropriate as derivative dealers manage the risk positions in their portfolio and not the individual transactions. As such, marking derivatives using mid-market prices ensures that offsetting risk positions are valued on the same basis. If the Board continues with its proposed guidance on bid-offer prices, then we recommend that the concept of marking "offsetting" risk positions to mid-market prices be permitted in all levels of the hierarchy and across the hierarchy. Offsetting risk positions exist between different levels of the hierarchy, for example fixed-rate debt security classified in Level One where the interest rate risk is offset by a pay-fixed LIBOR swap that is classified in Level Three.

Marking Liabilities for an Entity's Own Credit Spread

The ED requires that in estimating the fair value of liabilities, such estimate should consider the effect of the entity's credit standing so that the estimate reflects the amount that would be observed in an exchange between willing parties of the same credit quality. Several of our members believe it is only appropriate for an entity to include the effect of changes in its own creditworthiness when the entity has the ability to realize the effect. Other members do not generally support a requirement to recognize gains and losses on

liabilities due to changes in the creditworthiness of the reporting entity. While applying the fair value model for consistency to all financial instruments is appealing, change in the fair value of an entity's liabilities due to a change in its own credit rating gives counterintuitive results. Investors and creditors reading financial statements should not see improving leverage and increases in income when an organization's risk profile is increasing nor when its financial performance is deteriorating. Likewise, an organization whose credit rating is improving should not book losses solely for that reason, if contractual terms of the debt have not changed and the entity will not experience higher cash outflows solely due to its credit upgrade. For insurance contracts, the liability is dictated by the actions of the policy holder and not the actions of the insurer and therefore credit standing is irrelevant. Therefore, we recommend the Board meet with financial statement users and preparers to better understand the issues.

Use of Multiple Valuation Techniques

We are concerned with the requirement for preparers to incorporate multiple valuation techniques consistent with the market approach, income approach, and cost approach for the valuation of Level Three assets and liabilities. It has been our experience when doing valuations, or engaging valuation specialists, that one approach may be much more relevant under the circumstances despite the fact that information is available for other approaches. For instance, as indicated in the AICPA Practice Aid, *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, Standard 9 of the 2003 Uniform Standards of Professional Appraisals Practice states that, "This Standards Rule requires the appraiser to use all relevant approaches for which sufficient reliable data are available. However, it does not mean that the appraiser must use all approaches in order to comply with the Rule if certain approaches are not applicable".

We therefore respectfully request the Board to reconsider the language in the ED to allow management to use greater judgment in applying the appropriate valuation technique. Specifically, we think the guidance should only require that an entity consider other valuation techniques when determining the appropriate model and that the entity is not required to perform multiple valuation techniques each time the asset or liability is valued. Furthermore, the Board should acknowledge that if a technique is well-accepted in practice for valuing a particular instrument, then the entity should use that technique without considering the other alternatives.

Disclosures

We are opposed to the proposed disclosure requirements in the ED and do not believe the Board has provided sufficient basis for requiring such disclosures. Paragraph C65 of the ED's Basis for Conclusions provides the general statement that, "the disclosures required by this Statement would provide information that is useful to users of financial statements in assessing the effects of the fair value measurements used in financial reporting", but there is no mention of how the information will be useful or how it will be used. While we are able to see the merit for commercial and investment banking institutions to disclose financial assets and liabilities by the valuation technique used to estimate fair value, we are not convinced that this information is useful for other institutions. Furthermore, we do not understand the relevancy of disclosing the total unrealized gains

or losses for the period. Finally, we believe disclosing such information on an interim basis is excessive, especially for those outside commercial and investment banking institutions. We encourage the Board to engage financial statement users and preparers in a discussion to develop a disclosure framework for fair value that not only provides useful information, but the cost of which will not be prohibitive.

Field Testing Hierarchy

We are not aware of any specific research that the Board has done to validate the application of the proposed hierarchy to the wide variety of financial and nonfinancial assets and liabilities to which the ED would apply. We therefore believe that is imperative that the Board field test the proposed hierarchy to evaluate the results of the proposed valuation methodologies, to ensure that they provide the most appropriate measures of fair value and to better understand the costs to implement them across the wide range of circumstances covered by the ED.

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We appreciate the Board's consideration of these matters and welcome the opportunity to discuss any and all related matters. If you have any questions regarding this letter, please feel free to call me at (989) 636-1541.

Sincerely,



Frank H. Brod
Chair, Committee on Corporate Reporting
Financial Executives International