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October 13, 2009

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, Connecticut 06856-5116

**RE: Proposed Accounting Standards Update, *Improving Disclosures about Fair Value Measurements* (File Reference No. 1710-100)**

Dear Technical Director:

We appreciate the opportunity to respond to the Proposed Accounting Standards Update, *Improving Disclosures about Fair Value Measurements* (the “proposed ASU”). Although we agree with certain of the proposed disclosure enhancements that are described in the proposed ASU, we do not agree with the proposed disclosure of the effect of “reasonably possible” alternative Level 3 inputs. We believe *qualitative* descriptions of the significant inputs and how those inputs impact the fair value measurements would be more appropriate.

We do not support a quantitative disclosure based on “reasonably possible” alternative inputs because the broad definition of “reasonably possible” under U.S. generally accepted accounting principles (U.S. GAAP) would result in a wide range of alternative inputs that would need to be considered under the proposed requirement and disclosures that may not be consistent with the exit price notion in FASB Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements*. Further, disclosure of a range of fair values resulting from the use of any alternative Level 3 input whose likelihood is “more than remote” would be difficult to operationalize for financial statement preparers and may result in inconsistent application due to difficulties in identifying the appropriate range of alternative inputs. Should the Board wish to proceed with a quantitative disclosure requirement, the Board should consider disclosure of a range of measurements that considers only those alternative inputs which, in management’s judgment, result in the range of possible prices market participants would pay to purchase the asset, or receive to transfer the liability, at the measurement date (i.e., range of possible exit prices) rather than a disclosure requirement that considers any significant alternative input that is determined to have more than a “remote” likelihood of being used.



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## **Proposed Disclosures of Reasonably Possible Alternative Inputs in Level 3 Measurements**

### **Objective of the Disclosure Requirement**

As currently written, the proposed ASU does not clearly articulate what the Board believes should be disclosed about the sensitivity of Level 3 fair value measurements and how to determine the range of “reasonably possible” alternative inputs. The term “reasonably possible” in the proposed ASU is defined by reference to the ASC Master Glossary, which states that reasonably possible is “The chance of the future event or events occurring is more than remote but less than likely.” The definition of “reasonably possible” is premised on the occurrence of a *future* event, but fair value measurements are based on inputs as of the measurement date. As a result, it is not clear what future event or events are to be evaluated. If the Board decides to continue with the reasonably possible disclosure requirement, the Board should clarify the objective of the disclosure requirement. In addition, by definition, the range of “reasonably possible” alternative inputs does not include the fair value measurement that is recorded in the financial statements. Preparers use judgment to determine which fair value measurement is most representative of what a market participant would pay to acquire an asset or demand to assume a liability. Inherent in the fair value measurement is the assertion that the selected fair value measurement is the measurement determined to be the most likely from a market participant perspective. Disclosing information that by definition excludes likely inputs is not consistent with fair value measurements.

The proposed ASU also is not clear on whether the objective is to disclose reasonably possible exit prices or an even broader range of exit prices based on all reasonably possible inputs. The proposed ASU could be interpreted to require the disclosure of reasonably possible alternative exit prices that would be received from or paid to a market participant to sell an asset or transfer a liability. Alternatively, because the proposed ASU does not specify that the disclosures are limited to reasonably possible alternative exit prices, the proposed ASU could be interpreted to mean that entities must disclose a broad range of measurements that includes all iterations of reasonably possible inputs that could significantly impact fair value. To illustrate, the example disclosure in the proposed ASU uses four types of inputs for a mortgage-backed security. Assuming that each of these inputs has only two other reasonably possible alternative inputs (one higher than the input used in the fair value measurement and the other lower), there would be many different iterations that would need to be performed to determine the combination that produces the high and low ends of the range of values. Although the proposed disclosures would be aggregated by class, differences among the items in the class may require the valuation scenario to be performed at the individual asset or liability level. The range that would result from using various combinations of reasonably possible alternative inputs may produce an aggregate value range for a given class that is far wider than what market participants would consider a reasonable range of prices. The range of measurements resulting from consideration



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of all reasonably possible alternative inputs, rather than consideration of the price at which a market participant would transact at the measurement date, produces hypothetical values that are not consistent with the exit price premise underlying fair value measurements.

Because the proposed ASU is unclear about the objective of the proposed disclosure and what future events are to be considered, different interpretations and inconsistent application would likely result without further clarification by the Board.

We understand the disclosure of reasonably possible alternative inputs has been proposed, in part, to converge with the IASB's Exposure Draft on Fair Value Measurement dated May 2009 (IASB's ED). However, the use of reasonably possible in the Board's proposed ASU and the IASB's ED may have different meanings that may result in different implementations of the disclosures. The term reasonably possible has been previously defined, and used in practice, in the U.S. It is our understanding that there is not a formal definition of reasonably possible in International Financial Reporting Standards (IFRS). Because of this, significant differences may develop in how practice implements the term under IFRS versus U.S. GAAP. Absent an IFRS definition of reasonably possible, preparers under IFRS may use a significantly more narrow range in their determination of which alternative inputs (or exit prices) are reasonably possible than preparers under U.S. GAAP who would need to consider any alternative input (or exit price) whose probability is more than remote.

#### **Operability and Cost-Benefit Considerations**

Many Level 3 fair value measurements use multiple unobservable inputs in the determination of fair value. Also, by definition, the term "reasonably possible" includes any alternative inputs that are more than remote but less than likely. As discussed above, the combination of a Level 3 fair value measurement technique involving multiple unobservable inputs and a requirement to consider all reasonably possible alternative inputs that could be used may result in a very large number of valuation scenarios that would need to be performed to consider all of the reasonably possible alternative inputs that could significantly impact a fair value measurement.

We also note that existing system limitations and preparers' financial reporting processes may not allow for appropriate consideration of all of the expected economic interdependencies that may exist, and what effect those interdependencies may have on the different alternative inputs when one is changed in a particular fair value measurement technique. Although entities may currently monitor the sensitivity of fair value measurements, the information to be disclosed under the proposed ASU may be inconsistent with how those entities monitor sensitivity information as part of their internal risk management processes. We believe that both large and



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small entities may be forced to incur significant incremental efforts in both personnel and system resources to enable them to make the disclosures as currently proposed.

The complexity and effort is compounded for those entities that have a significant number of investments and assets carried at fair value, for example, private equity funds. Additionally, the disaggregation of the disclosure by class may require additional effort for some entities to first determine the appropriate level of aggregation and then to compile the information by class.

Further, many financial statement preparers utilize pricing services or brokers in their consideration of Level 3 inputs. Many of those financial statement preparers may need to obtain additional information from third party providers for their analysis of potential alternative inputs which would result in an additional burden for preparers to comply with the proposed disclosure requirement.

#### **Inconsistency with Existing Disclosure Requirements**

The disclosure of the fair value ranges that would be required by the proposed ASU may create confusion for certain types of Level 3 assets and liabilities because of similar, but not identical, disclosure requirements that already exist. For example, ASC paragraphs 860-20-50-3 through 860-20-50-9 contain disclosure requirements for retained interests in transfers of financial assets in securitization or asset-backed financing arrangements accounted for as sales. Among these requirements, an entity must disclose a sensitivity analysis or stress test showing the hypothetical effect on the fair value of those retained interests of two or more unfavorable variations from the key assumptions used in the fair value measurement. Additionally, these disclosures are to be made without consideration of changes in other key assumptions. Because many of the retained interests subject to existing disclosure requirements are classified as Level 3 fair value measurements, they would also be subject to the disclosure of the effect of reasonably possible alternative Level 3 inputs. Providing disclosure of hypothetical fair value changes in different manners for the same assets and liabilities may be confusing for financial statement users.

#### **Recommendations**

As stated previously, we do not believe the disclosure of quantitative information based on reasonably possible alternative inputs as drafted in the proposed ASU provides benefits that justify the incremental cost of preparing such disclosures, and we urge the Board to remove this disclosure requirement from the proposed ASU. Instead, we recommend the Board consider sensitivity disclosures that are qualitative in nature, requiring entities to describe alternative inputs that were considered in the fair value measurement process and the level of sensitivity related to different management judgments of alternative inputs that market participants would



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likely use in pricing the asset or liability, consistent with the notion of exit price. To the extent entities currently perform sensitivity analysis as part of their existing risk management activities, the Board should consider allowing entities to disclose that information in lieu of the disclosures in the proposed ASU. Should the Board decide to proceed with a requirement for specific quantitative disclosures, we believe the quantitative disclosure should be based only on those alternative inputs which, in management's judgment, result in the range of possible prices market participants would pay to purchase the asset or receive to transfer the liability at the measurement date (i.e., a range of possible exit prices), rather than a disclosure requirement that considers *any* significant alternative input that is determined to have more than a remote likelihood of being used. If the Board decides to retain disclosure of a specific quantitative range, the FASB should also work with the IASB to develop a disclosure standard that would result in similar application for U.S. GAAP preparers and IFRS preparers.

### **Rollforward of Level 3 Fair Values**

We agree that the requirement in the proposed ASU to separately disclose purchases, sales, issuances, and settlements of assets and liabilities in the Level 3 fair value rollforward provides useful information and believe that preparing such disclosure is operational.

### **Determination of Significance**

For purposes of determining whether the disclosure of the effects of reasonably possible alternative inputs is appropriate, we believe that significance should be considered at the class of assets or liabilities. However, as written the proposed ASU refers to the determination of significance being made at the point of the "fair value measurement" which may be interpreted to apply to the unit of account for a fair value measurement (e.g., the individual financial instrument). We believe the Board should clarify this distinction in its re-deliberation of the proposed ASU.

### **Unrealized Gains and Losses for Level 3 Assets or Liabilities Held at the Reporting Date**

Although not specifically addressed in the proposed ASU, we are aware of diversity in practice related to the disclosure of total gains and losses for Level 3 fair value measurements that are attributable to the change in unrealized gains or losses for those assets and liabilities still held at the reporting date (ASC paragraph 820-10-50-2(d)). Many entities determine this amount by identifying which Level 3 assets or liabilities are still held at the reporting date, and quantify the amount of unrealized gains and losses arising during the quarter for those specific items, which results in the sum of the amounts disclosed quarterly not being equal to the year-to-date amounts. Other entities "recycle" unrealized gains or losses from prior periods, which results in the sum of the quarterly disclosures equaling the year-to-date amounts. Certain financial statement users



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may consider the effects of Level 3 unrealized gains or losses in their analysis of the financial results of an entity, and the diversity in practice may impact that analysis. Because the proposed ASU intends on expanding these rollforward-type disclosures to include Level 1 and Level 2 fair value measurements, we suggest that the Board use this opportunity to clarify the manner in which unrealized gains and losses are to be disclosed.

### **Application to Nonrecurring Fair Value Measurements**

Although not specifically addressed in the proposed ASU, diversity in practice may develop related to disclosure of assets or liabilities that are measured at fair value on a nonrecurring basis in periods subsequent to initial recognition. The Basis for Conclusions in Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, contained guidance indicating that the disclosures related to nonrecurring fair value measurements were not intended to apply to assets or liabilities measured at fair value at the date of initial recognition and not subsequently remeasured at fair value on a recurring basis. Because the guidance in the Basis for Conclusions was not codified, a potential practice issue could result in varying interpretations of the applicability of the disclosure requirements to these assets and liabilities. The Board may wish to include clarifying information in this proposed ASU to eliminate this potential practice issue.

### **Effective Date**

Considering the expected timing of the issuance of a final ASU, we do not believe preparers will have sufficient time to appropriately implement the systems and financial reporting processes to comply with proposed disclosure requirements by the proposed effective dates. Because many of the entities that will be most affected by the proposed ASU will also be adopting Statement of Financial Accounting Standards No. 166, *Accounting for Transfers of Financial Assets*, Statement of Financial Accounting Standards No. 167, *Amendments to FASB Interpretation No. 46(R)*, and potentially the proposed Accounting Standards Update *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* on or around the same date, the Board should carefully consider feedback from preparers as to whether it is operational to properly implement multiple significant accounting standards simultaneously.

Further, we believe that if the Board does proceed with its requirement to disclose the effect of reasonably possible Level 3 inputs, that disclosure should not be required in interim periods.



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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 or Robert Hilbert at (212) 909-5303.

Sincerely,

KPMG LLP