



Ernst & Young LLP
5 Times Square
New York, NY 10036
Tel: 212 773 3000
www.ey.com

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

12 October 2009

Proposed Accounting Standards Update, "Improving Disclosures about Fair Value Measurements"

File Reference No. 1710-100

Dear Mr. Golden:

We appreciate the opportunity to provide comments to the Financial Accounting Standards Board (FASB or the Board) in response to the Proposed Accounting Standards Update to Topic 820, *Fair Value Measurements and Disclosures* - "Improving Disclosures about Fair Value Measurements" (the proposed ASU). We generally support the Board's effort to improve upon the existing fair value disclosures required under FASB Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures* (ASC 820), as we believe meaningful, transparent disclosures regarding fair value measurements serve to increase investor confidence in financial reporting. However, we have certain concerns with respect to the requirements outlined in the proposed ASU, particularly pertaining to the sensitivity disclosures for Level 3 measurements.

Sensitivity Disclosures

Given the subjective nature of fair value measurements determined using significant unobservable inputs (i.e., Level 3 measurements), we agree that additional disclosures enabling users to better assess these measurements would be useful. Level 3 measurements are inherently judgmental, and like many other accounting estimates, a range of reasonable "amounts" likely exists for this estimate. Absent the competitive market forces required to derive a single market clearing price at a particular point in time, use of a single point estimate to measure fair value is essentially an accounting expedient. Nevertheless, ASC 820 is clear that the objective of a fair value measurement is "to determine the point within [the] range that is most representative of fair value under current market conditions." The proposed ASU would require entities to disclose the effect(s) of changing significant unobservable inputs to reasonably possible alternative inputs if such changes would increase or decrease the Level 3 fair value measurement significantly. This requirement appears to be aimed at providing users with additional transparency into the range of values considered by management in determining the single point estimate that was concluded to be the most representative of fair value at the measurement date. While conceptually appealing, we have a number of concerns regarding the use of such an approach. These concerns include the following:

- ▶ The determination of reasonably possible alternative inputs is also very subjective and therefore likely to result in disparate views amongst preparers.

The Master Glossary of the FASB Accounting Standards Codification defines “reasonably possible” as “[t]he chance of the future event or events occurring is more than remote, but less than likely.” The application of this definition to the inputs used to determine fair value is confusing. The determination as to when an event that drives an input (such as a default rate) reaches the level of being “remote” or “likely” is extremely judgmental and could require a conclusion that is not explicitly considered in the determination of fair value.

- ▶ The sensitivity disclosures in the proposed ASU appear to be focused more on assessing management’s judgment in determining where fair value falls within a range of values than on the “sensitivity” of the measurement to changes in the underlying inputs.

Preparers have expressed concerns that such an approach will lead to the disclosure of proprietary information that could affect their business. These concerns focus on potential litigation and regulatory risks (e.g., if an input that was considered remote actually proves to be the ultimate outcome, as discussed further below), as well as competitive factors. In addition, such an approach would seem to increase the tension regarding the use of fair value as a measurement objective for Level 3 assets and liabilities. That is, disclosure of a large range of potential values might suggest that fair value is an insufficiently reliable measurement attribute.

While we understand the theoretical appeal of such information in assessing an entity’s quality of earnings, disclosing a range of other “acceptable” values that could reasonably have been recorded by the Company as of the measurement date could be misleading. Assessing various indications of value and determining the point estimate that is deemed to be the most representative of fair value is judgmental and frequently complex. Often, certain indications of value will be determined to be less relevant than others based on facts and circumstances specific to the particular asset or liability being valued. Disclosing the specific facts and circumstances related to the various classes of Level 3 measurements does not seem practical. However, absent such clarification, we are concerned that users may improperly conclude that all amounts within the range of value disclosed are equally representative of fair value.

- ▶ Finally, although the proposed ASU is clear that the sensitivity disclosures are intended to provide information as to the potential variability in significant unobservable inputs based on information that exists as of the measurement date, and that these disclosures do not contemplate worst case scenarios, we are concerned with how the proposed disclosures may be interpreted by some users. That is, we are concerned that despite the FASB’s effort to clarify their purpose, many users will consider the range of value disclosed in accordance with the proposed ASU to represent a boundary on the fair value of the assets and liabilities in the future.

As a means to address these concerns, we suggest that the Board consider a revised approach that is focused more precisely on disclosing the magnitude by which an entity’s Level 3 fair value measurements would change given a predefined change in a significant assumption (say, 5% or 10%). For example, in the illustrative example provided in the proposed ASU, the entity would disclose the change in fair value of its residential mortgage backed securities portfolio that would result from a 5%

change in the weighted-average probability of default assumptions used in its valuation model. Under this approach, the other inputs used in the valuation of the entity's RMBS portfolio would be adjusted for movements that would be commensurate with a 5% change in probability of default assumptions considering the correlation of these inputs to default rates. (See our comment below on the need for additional guidance when considering correlation.) Such an approach would provide financial statement users with additional information on how "sensitive" the entity's Level 3 measurements are to unobservable inputs without implying an alternative range of values that could have been recorded in the financial statements. This disclosure would highlight, for example, the increased sensitivity of a highly levered asset (or portfolio of assets) to a change in the assumption regarding a discount rate, as compared with an asset that is less levered. Providing this type of information to financial statements users would enable them to make their own assessment as to the potential range of fair value for Level 3 measurements, given their own views on the inputs used in the valuation.

In our view, predefining the change in unobservable inputs would eliminate many of the difficulties noted above with respect to the determination of reasonable possible alternative inputs. In addition, while not necessarily reducing the complexity of the calculation, such an approach would alleviate the concerns noted above regarding the disclosure of proprietary information and the potential for the disclosures to be misunderstood.

Irrespective of the Board's conclusion with respect to the revised approach discussed above, there are a number of other practical issues we believe the FASB needs to address pertaining to the application of the sensitivity disclosure requirements.

Application to all level 3 measurements

Under the proposed ASU all Level 3 fair value measurements (with the exception of alternative investments within the scope of Accounting Standards Update No. 2009-12, "Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)"), are subject to the sensitivity disclosures. That is, if applicable, the disclosures apply to both recurring and non-recurring Level 3 measurements. While we do not disagree that this type of disclosure is useful for all Level 3 measurements, we have concerns about the operability of these requirements for certain types of assets and liabilities. For example, we question how the sensitivity disclosures would be applied to goodwill that is written down to its fair value as a result of an impairment recognized in accordance with Accounting Standards Codification Topic 350, *Intangibles - Goodwill and Other* (ASC 350). The implied fair value of goodwill is not determined directly, but instead is determined based on the excess of the fair value of a reporting unit over the amounts assigned to its identifiable assets and liabilities (generally based on their fair values). Typically, step two of a goodwill impairment test under ASC 350 contains many Level 3 fair value measurements (e.g., the reporting unit itself, intangible assets, capital equipment, etc.). Given that there are no direct inputs used in estimating the implied fair value of goodwill, it is unclear whether an entity would need to consider reasonably possible alternative inputs for determining the fair value of the reporting unit and its Level 3 assets and liabilities. Such an approach would seem highly impractical, overly complex and potentially confusing to financial statement users.

In considering the sensitivity disclosures outlined in the proposed ASU, it appears the Board was primarily focused on their application to financial instruments (as illustrated in example D), which generally have a limited number of unobservable inputs. In addition, under current International

Financial Reporting Standards (IFRS), similar sensitivity disclosures are limited to financial instruments, as required under IFRS 7, *Financial Instruments: Disclosures* (IFRS 7). The application of these requirements to other asset classes, such as privately held portfolio companies (measured at fair value by private equity funds in accordance with ASC 946, Financial Services-Investment Companies), create certain challenges that may not have been fully contemplated by the Board. For example, the valuation methodologies used to estimate the fair value of a private company generally incorporate many unobservable inputs that could have a significant effect on the valuation (such as projected cash flows, growth rates, discounts rates and marketability discounts; to name a few). Determining the effects of reasonably possible alternative inputs for all of the significant unobservable inputs used in such a valuation could be extremely complex and time consuming. In addition, unique assets (such as investments in portfolio companies by private equity funds) create additional challenges with respect to aggregation, as providing the sensitivity disclosures in the proposed ASU for a portfolio of companies with different risks would likely not provide meaningful information.

As part of its redeliberation process, we recommend that the FASB perform additional analysis regarding the application of the proposed disclosures to nonfinancial assets and liabilities. As part of this analysis the Board should consider whether alternative approaches could be provided for certain classes of assets and liabilities (e.g., goodwill and other nonfinancial assets and liabilities) that would be operational, but still meet the objectives of the proposed disclosures. Alternatively, the Board could reconsider the scope of Level 3 measurements subject to the sensitivity disclosures.

Correlation of inputs

The proposed ASU notes that “in determining reasonably possible alternative inputs, the reporting entity shall consider the current economic environment(s) in which it operates, including the expected effects of correlation among changes in significant inputs if estimating the effect of more than one reasonably possible change.” We agree that incorporating the expected effects of correlation amongst the various inputs used in a valuation technique is critical to providing meaningful sensitivity disclosures. In our view, the decision-usefulness of sensitivity disclosures is greatly diminished when changes to individual inputs in a valuation technique are considered in isolation of other interrelated inputs. Such an approach results in amounts that are not representative of the true sensitivity of the asset or liability in its entirety to changes in unobservable inputs (whether based on predefined changes to inputs or reasonably possible alternative inputs).

However, we believe the Board should provide further clarifying guidance with respect to incorporating correlation among assumptions and disclosing the total effects of changes in situations in which there are multiple unobservable inputs that would have a significant impact on the overall fair value measurement.

- ▶ Determining the correlation between unobservable inputs on a quantitative basis may be challenging given the lack of market data related to these inputs. In fact, for certain products, correlation could be an unobservable input that is significant to the overall fair value of the instrument. As such, the Board should clarify its expectations with respect to how (or whether) correlation between unobservable inputs (as well as between unobservable and observable inputs) is to be considered.

- ▶ The number of possible outcomes provided by the sensitivity analyses described in the proposed ASU can increase exponentially as the number of unobservable inputs deemed to be significant to the overall fair value measurement increase, particularly when the reasonably possible alternative inputs show minimal correlation. We recommend that the Board clarify that the “total effect(s) of the changes” required to be disclosed by the proposed ASU represents a single range from the lowest estimate to the highest estimate produced by this analysis (rather than separate ranges for each input considered).

Current sensitivity disclosures under ASC 860

FASB Accounting Standards Codification Topic 860, *Transfers and Servicing* (ASC 860), requires a specific sensitivity disclosure for retained interests. ASC 860-20-50-4c states that entities should perform a sensitivity analysis or stress test showing the hypothetical effect on the fair value of retained interests of two or more unfavorable variations from the expected levels for each key assumption used in their valuation, considered independently from any change in another key assumption. Given the new disclosures in the proposed ASU, such a requirement seems redundant for residual interests measured at fair value using significant unobservable assumptions. As such, upon the issuance of any final guidance that requires new sensitivity disclosures broadly, we recommend the Board clarify that the sensitivity disclosures in ASC 860-20-50-4c would not be applicable.

In addition, consistent with the objective of its Disclosure Framework project, the FASB should assess whether any other current disclosures required under U.S. GAAP would be deemed redundant or less relevant given the new disclosure requirements in the proposed ASU. Further, given the objectives of the Disclosure Framework project, we believe that the Board should carefully consider whether continuing to issue standards requiring incremental disclosures is appropriate, particularly when the new standard does not introduce new accounting requirements.

Effective Date

In our view, the proposed effective date is not operational. We strongly believe that the proposed transition period will not be sufficient for entities to appropriately prepare for the expanded disclosure requirements. It is our understanding that the implementation of the new required disclosures in the proposed ASU will require a substantial amount of effort, as much of the information required to be disclosed is not currently captured by preparers. This information is not limited solely to the sensitivity disclosures, but also includes gross information about issuances, settlements, purchases and sales of Level 3 measurements. The process to accumulate the information for the Level 3 reconciliation is manually intensive for most preparers, as many current systems do not track or accumulate this information. As such, we have been informed by a number of preparers that compiling gross information regarding Level 3 measurements will be challenging and time consuming.

As discussed throughout this letter, the sensitivity disclosures in the proposed ASU create a number of challenging implementation issues that will need to be addressed as constituents prepare to meet these requirements. While entities that report under IFRS will be required to make similar sensitivity disclosures in their 2009 annual financial statements, we note the following:

- ▶ The sensitivity disclosures under IFRS 7 relate only to financial instruments.

- ▶ The requirements under IFRS 7 do not address the consideration of the expected effects of correlation among changes in significant inputs. It is our understanding that most entities reporting under IFRS do not (or do not plan to) incorporate the effect of correlation among various valuation inputs in their sensitivity disclosures.
- ▶ Sensitivity disclosures related to financial instruments measured at “fair values recognized or disclosed in the financial statements determined in whole or in part using a valuation technique based on assumptions that are not supported by prices from observable current market transactions in the same instrument “ were previously required under IFRS 7. The amendments made to IFRS 7 in March 2009 by *Improving Disclosures about Financial Instruments*, required that entities now disclose how the effect of a change to a reasonably possible alternative assumption was calculated. While we understand that this requirement has led many entities to re-assess their historical sensitivity disclosures under IFRS 7 and consider the level of disaggregation at which these disclosures are made, these entities are able to build from their historical practices.

Considering all of the factors noted above, the transition period in the proposed ASU seems extremely short given that entities that report under IFRS were provided a nine month transition period. In order to provide adequate time for constituents to effectively comply with the new disclosure requirements, we believe that the Board should provide a transition period of no less than nine months after the FASB issues a final standard.

* * * * *

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

A handwritten signature in black ink that reads 'Ernst & Young LLP'.