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File Reference No. 1830-100 Exposure Draft:

Fair Value Measurement & Disclosures (Topic 820)
Amendments for Common Fair Value Measurement and Disclosure Requirements in US
GAAP and IFRS

Dear FASB:

This letter contains my comments on the exposure draft (ED) from the perspective of a financial statement user and educator. I concur that the changes to US GAAP are relatively minor with a bigger impact for companies reporting under IFRS. I am primarily concerned that lengthy disclosures may give the illusion of providing beneficial information regarding assets or liabilities measured without of observable market values. These disclosures are costly for preparers and, I argue, costly for financial users to process and incorporate into their decisions. As an informed user, I am aware that Level 3 measurements are only pretending to be market values. The worst case scenario is that the actual value is nil. So the really important information is the proportion of “real” valuations (Level 1 and 2) to the financial position of an entity. If the impact of items measured at Level 3 might have a significant impact on my overall evaluation of financial health, I might spend time trying to figure out just how the guesstimates were made and the range of values that could have been readily obtained using different assumptions.

For purposes of classifying comment letters, my title is professor of accounting and I am employed at the University of Idaho. I have held my CPA license since 1977. Prior to beginning my 28-year academic career, I held a variety of positions including staff accountant in a small public accounting firm, controller for several small to medium-size business entities, and as director of finance for a large not-for-profit entity. As an active donor and small investor, I have occasion to read the financial information of charities and publicly-traded companies.

Question 1: This Exposure Draft represents the Board's commitment toward developing common fair value measurement guidance with the IASB. Do you think the proposed amendments:
a. Would improve the understandability of the fair value measurement guidance in U.S. GAAP? If not, why not?

I assume that the need to standardize fair value measurement is related to a continuing move toward increased use of "fair values." I am concerned that what we designate as a "fair value" implies a "fair market value" and the expansion of the application of fair value measurement may in fact reduce the understandability of US GAAP.

I prefer the term "market value" over "fair value" because I don't think "pure estimates" are really market values at all and calling them "fair value" doesn't change that fact. Accordingly, financial statement users may put more faith in something labeled "fair value" than is really warranted. Estimates have long been a part of the accounting process – we have been estimating useful lives, contingent liabilities like bad debts, and other assets, liabilities, revenues and expenses for at least a century. Now we are estimating the value of certain assets and liabilities that have essentially no observable market inputs and then pretending that these estimates are equivalent to market values. Financial statements have always been and will continue to be historic documents – they tell us about conditions that existed in the past. The information can be helpful in predicting the future but a market value from two months ago is not necessarily closer to current market value than the original transaction cost would be. I have no problem with reporting the "real" fair values (Level 1 and most Level 2 fair value measurements). The ED spends considerable attention on the "less real" fair values measured without much in the way of observable inputs. I think users would be better informed if the term "fair value" or "fair market value" were limited to Level 1 and Level 2 measurements. Assets (and some liabilities) measured with few observable inputs could be referred to as "estimated current exit value" or a similar term.

We used to designate some measurements as NRV or "net realizable value." As far as I know, accounts receivable is still measured at NRV. Given the short-term nature of trade receivables, isn't net realizable value pretty close to something we could call a Level 3 fair value? On the other hand, the NRV is actually a better figure than an estimated exit value because it represents real resources to be available soon. Changes in fair value give rise to gains and losses that may not be realized until dates far in the future. Therefore, net income becomes potentially less useful – particularly if we start including unrealized gain or loss for having a mortgage on long-lived assets. Too much fair value reporting almost forces a person to look to the statement of cash flows for what is "real" versus what may never be realized – since today's market value will undoubtedly be different than next year's market value.

b. Would result in any unintended consequences on the application of the proposed amendments? If so, please describe those consequences.

I'd like to focus on the unintended consequences for not-for-profit financial statements. As a donor, I am most interested in readily available resources that could be used to deliver charitable goods and services and the resources that were actually used to deliver program services as well as fundraising efforts and administration. Unrealized gains and losses cannot be spent and may never be realized. I favor reporting of investments at fair value because they could be sold

quickly (in most cases) if needed. In contrast, a gain on long-term debt is not an available resource and a loss on long-term debt is not related to providing charitable goods and services. Likewise, reporting gains and losses related to postretirement benefit plans that are not included in our best estimate of the cost of providing the benefit to employees is more likely to be confusing than helpful. Accordingly, FASB has told not-for-profit entities to exclude this “other comprehensive income” item from functional expense reporting. Given the current efforts to converge with US GAAP and IFRS, it may no longer be possible to treat not-for-profit entities as a special industry that almost always follows the same standards as a for-profit business entity. Donors have distinctive needs that do not completely match the needs of the investors and creditors of for-profit entities. Increased use of fair value measurements on the balance sheet with the inherent impact on the statement of activities may not benefit donors and other users of not-for-profit financial statements.

Question 2: The Board has decided to specify that the concepts of highest and best use and valuation premise are only to be applied when measuring the fair value of nonfinancial assets. Are there situations in which those concepts could be applied to financial assets or to liabilities? If so, please describe those situations.

This was a good decision. I can’t think of ANY liability to which highest and best use would apply. With respect to financial assets, I think it better that accountants not be asked to decide whether certain stocks or bonds are “better” for one use or another (e.g., retirement plans versus holding for short-term return). Those “opinions” are certainly held by market participants but I am not aware of any circumstances where the purchase price differs depending on “why” the purchaser decides to buy a financial asset.

Question 3: Do you agree with the proposed guidance for measuring the fair value of an instrument classified in shareholders’ equity? Why or why not?

Apparently, this is intended only to value “own equity” shares for business combinations or perhaps an element used in a model to measure employee stock-based compensation. I can’t think of any particular problem in that type of situation. It would, of course, be ridiculous to carry equity securities at fair value on the balance sheet. Markets rely on accounting information to determine the price of equity shares – to include market values on the financial statements would lead to circular reasoning and invalid decision making.

Question 4: The Board has decided to permit an exception to fair value measurement requirements for measuring the fair value of a group of financial assets and financial liabilities that are managed on the basis of the reporting entity’s net exposure to a particular market risk (or risks) (that is, interest rate risk, currency risk, or other price risk) or to the credit risk of a particular counterparty.

a. Do you think that proposal is appropriate? If not, why not?

This was the most nonsensical part of the ED – language seems to say you can group them but it also says you can NOT use the value so obtained. Maybe there is a typo or it is just written poorly? Paragraphs 820-10-35-18J to 18M go on and on about how to qualify for and use the exception. Then 820-10-35-18I says the fair value measurement so obtained “does not apply to financial statement presentation.” If you can’t use it for financial statement presentation, why do we need several paragraphs describing the method. I admit to total confusion!

b. Do you believe that the application of the proposed guidance would change the fair value measurements of financial assets and financial liabilities that are managed on the basis of the reporting entity's net exposure to those risks? If so, please describe how the proposed guidance would affect current practice.

I have no idea about the impact on current practices. However, since the purpose is completely opaque given that the measures can't be reported, I don't see what current practice has to do with it.

Question 5: The Board has decided to clarify the meaning of a blockage factor and to prohibit the use of a blockage factor when fair value is measured using a quoted price for an asset or a liability (or similar assets or liabilities). Do you think that proposal is appropriate? If not, why not?

It would certainly be helpful if the board/staff would direct us to a particular page or paragraph in this 200+ page document. I think I recall reading the passage in question and it did not seem to be much different from my understanding of existing GAAP. However, I do not claim any expertise in developing fair values using existing standards.

Question 6: The Board has decided to specify that other premiums and discounts (for example, a control premium or a noncontrolling interest discount) should be taken into account in fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy when market participants would take into account those premiums or discounts when pricing an asset or a liability consistent with the unit of account for that asset or liability.
a. Do you think that proposal is appropriate? If not, why not?

Based strictly on logic, it would make more sense to stick with observable market values when they exist and not go around making somewhat arbitrary adjustments to them. In other words, the types of premiums or discounts discussed in the ED should only be taken into consideration in the computation of the Level 3 guesstimates.

b. When the unit of account for a particular asset or liability is not clearly specified in another Topic, how would you apply that proposed guidance in practice? Please describe the circumstances (that is, the asset or liability and the relevant Topic) for which the unit of account is not clear.

I have no practical experience to share on this topic. As a user of financial information, I get really nervous thinking about all the subjectivity that goes into these measurements. I would be even more terrified if I were asked to audit them.

Question 7: The Board has decided to require a reporting entity to disclose a measurement uncertainty analysis that takes into account the effect of correlation between unobservable inputs for recurring fair value measurements categorized within Level 3 of the fair value hierarchy unless another Topic specifies that such a disclosure is not required for a particular asset or liability (for example, the Board has decided in its project on the accounting for financial instruments that a measurement uncertainty analysis disclosure would not be required for investments in unquoted equity instruments). Do you think that proposal is appropriate? If not, why not?

This is the portion of the ED that is the most troublesome to me. The layout in example 820-10-55-80 (as amended) is nice and concise – but that doesn't mean it is costless to prepare or costless for the financial statement reader to interpret and put to use. In contrast, the introduction of the three levels of measurement was an excellent device to let the reader get a good understanding of the "measurement uncertainty." As a financial statement user, I know that Level 1 indicates good solid "market values" that are readily audited. Level 2 is not as solid but is at least based on something "real" that goes beyond management's best estimate. Everyone

now knows that Level 3 measurements are “softer” and less likely to be “true” as compared to Level 1 measurements. So it may not be too important to try to take the “uncertainty” analysis a lot further, i.e., the disclosure of an uncertain range for an uncertain measurement does not increase my comfort level. If management is dishonest, none of the figures may be realistic. Even if the numbers were solid on the reporting date, market conditions change with great speed. Even the observable measurements will be different a few days later! In that sense, cost may be just as good because at least the cost figure was a “real” market value at the transaction date.

For the further distillation of the uncertainty analysis for inherently uncertain numbers, I think it may be important to treat assets and liabilities differently.

Application to liabilities. For many liabilities, I’m not sure the “uncertainty analysis” is particularly useful. For most financial instruments like bonds or mortgages, the maximum amount owed is the contractual balance due. Disclosing face and fair value might let me evaluate management – maybe they should think about refinancing if fair value is less than carrying value (but that isn’t even a good decision model if new higher interest debt replaces the current lower interest debt). If the fair value of a liability is higher than carrying value, who cares? The company can merely continue paying the liability and it will never have to pay more than the contractual amounts. On the other hand, it would be useful to have disclosures for the MAXIMUM reasonable value for estimating liabilities that do not involve contractual figures – like environmental liabilities or other contingencies. In other words, I think the desired disclosure is one-sided: tell me the worst case scenario and the best estimate. I think I’d ignore the “best case” scenario for estimated liabilities given the very high level of uncertainty. If nothing else, the FASB and IASB should say something to the effect that the “worst case” fair value for liabilities would never exceed face or redemption value (if one exists).

Application to assets: On the asset side, the desirable information is, again, the worst case scenario – the MINIMUM reasonable value from the estimation models along with managements’ best estimate. In other words, users like myself would be more interested in one side of the uncertainty distribution rather than the full range of possibilities. On the asset side, it is reasonable to conclude that the absolutely worst case scenario is always ZERO. I’m willing to assume zero in my analysis unless management chooses to tell me that a different value is more likely than not to occur. If the assets measured at Level 3 are a small portion of all assets, then I think it should be up to management to decide whether they want to provide the extra disclosures. If no “worst case” figure is provided, my analysis can proceed using an assumption of zero or 50% of the value reported or whatever. Since uncertainty is high in the first place, I do not see how reporting the range is any more accurate than the “best guess.” It would be great if we could get something like a figure with a 95% confidence level (e.g., the model predicts a number within 10% of this value 95 times out of 100 regardless of inputs). I just don’t think that is possible.

So, if there needs to be more disclosure about uncertainty within the measurements that are already labeled “most uncertain” (Level 3), maybe the problem is that we need MORE LEVELS of measurement. Perhaps Level 4 could be “no observable inputs at all” while Level 3 could be “some observable inputs but not enough.” Better yet, in my opinion, would be to back away

from pretending to measure market values when there are no markets. Making assumptions about assumptions of market participants just seems very farfetched to me. If it isn't Level 1 or Level 2, maybe it should not be called fair value but merely an estimated value. Assets with high levels of measurement uncertainty could be reported at cost unless impaired and liabilities with a high level of measurement uncertainty could be identified as estimates rather than fair values.

Avoiding disclosure by claiming that something is “not material” is always possible. The auditors generally want to analyze everything anyway before they agree that it is not material. Many small organizations would be spending more for their audits if this additional disclosure requirement is implemented, not to mention the cost of developing the information. When it comes to charities, I really don't think an extensive analysis and reporting of the level of uncertainty is how I want my donation to be used. For a small charity, the mere existence of substantial amounts of assets measured at Level 3 would be a red flag to me (given the kinds of assets currently measured at fair value under US GAAP). If a not-for-profit has sufficient resources to invest, they should be doing it safely and not taking on large amounts of risk (that would be my opinion as a donor).¹ As I re-read this statement, I realize that I am making an assumption that is probably erroneous – just because Level 1 has less measurement risk, it does not necessarily have less market risk. How many other small investors, creditors, and donors are likely to make that same assumption? However, the point stands – if we can't readily determine the value of an investment, that investment is inherently more risky than a similar investment with a readily determinable value because it is harder to know when to sell and whether the carrying value is realizable.

Question 8: Are there alternative disclosures to the proposed measurement uncertainty analysis that you believe might provide users of financial statements with information about the measurement uncertainty inherent in fair value measurements categorized within Level 3 of the fair value hierarchy that the Board should consider instead? If so, please provide a description of those disclosures and the reasons why you think that information would be more useful and more cost-beneficial.

See comments under Question 7 regarding making the required disclosure different for assets and liabilities or possibly adding a Level 4 instead of the uncertainty analysis.

Question 9: The Board has decided to require limited retrospective transition. Do you think that proposal is appropriate? If not, why not?

Good decision. For US companies, the disclosures are not sufficiently different to require retrospective transition.

Question 10: There is no link to the transition guidance for the proposed amendments that the Board believes would not change practice. Are there any proposed amendments that are not linked to the transition guidance that you think should be linked? If so, please identify those proposed amendments and why you think they should be linked to the transition guidance.

¹ Obviously, colleges and universities, foundations, and other charities with large endowments should have sophisticated staff and will likely have some Level 3 “alternative” investments as part of a diversified portfolio.

A related issue: I am finding it extremely hard to use the codification when multiple versions of paragraphs are all being presented in sequence one after the other. If this ED is finalized, lots of things that didn't really change much were moved around. I think these changes will be very confusing to use if put into the ASC in the same way as some of the earlier changes I've seen. Perhaps you need to come up with a separate SECTION (clearly labeled) for each implementation date rather than interspersing the changed paragraphs throughout the topic. In other words, have an old GAAP section and a new GAAP section, each complete with everything one needs to know to use that topic.

Question 11: The amendments in this proposed Update would apply to public and nonpublic entities (that is, private companies and not-for-profit organizations). Should any of the proposed amendments be different for nonpublic entities? If so, please identify those proposed amendments and describe how and why you think they should be different.

Nonpublic entities and not-for-profit entities should be scoped out of the additional "uncertainty analysis" disclosures for Level 3 assets and liabilities. The reasons should be clear from responses to earlier questions.

Question 12: How much time do you think constituents would need to prepare for and implement the amendments in this proposed Update?

Other than the uncertainty analysis disclosures for Level 3 assets and liabilities, the impact on US companies is not very substantial so it wouldn't seem like a lot of time would be needed. However, it might be better to figure out what happens with the financial instruments ED before making this change. I don't see much benefit to rushing this one since the changes do not appear to make the measurement or disclosure of fair values much better than what we have right now.

Sincerely,

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