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

File Reference: 1830-100

Dear Mr. Golden:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Financial Accounting Standards Board's ("FASB" or the "Board") proposed Accounting Standards Update (ASU), *Fair Value Measurements and Disclosures (Topic 820) – Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS* ("ED"). We support the Board's objective of promoting high quality standards for fair value measurements and disclosures, while improving comparability of international financial reporting. Although we generally agree with proposals that will enhance consistency between U.S. generally accepted accounting principles (U.S. GAAP) and International Financial Reporting Standards (IFRS), we believe this ED should be modified in the following areas.

Measurement uncertainty analysis disclosure

We are not supportive of the Board's disclosure requirements for measurement uncertainty. We understand that the Board has received feedback from certain financial statement users indicating that information about the measurement uncertainty inherent in Level 3 fair value measurements, including the effects of correlation, may be helpful to have. While relevant and useful information is key to understanding the financial statements, we have serious reservations as to whether this proposed disclosure will provide meaningful information that comports to what the Board may intend. We also believe the proposed disclosure will be difficult and costly to implement.

Further, based on our review of the proposal and our understanding of how it can and would be implemented by reporting entities, we believe the information it requires would only be useful if presented for each individual position within a portfolio or asset or liability class. Information relevant to an uncertainty "range" loses much of its meaningfulness when aggregated, such as at the class level, because the range within a class may not be homogenous (or comparable) or may be impacted by other factors, such as offsetting positions (e.g., when the offsetting positions are observable). Despite the greater relevance of this information at a disaggregated level, we believe that it would be immensely complex and not feasible to produce, and would result in a disclosure where volume overwhelmed any meaningfulness. Furthermore, disclosure at a disaggregated level may provide competitive information that could be harmful to a reporting entity.



We also believe the requirement as articulated in the ED is not clear. Based on the illustrative example in the ED and the supplementary materials produced by the staff, it appears that what would be required by the proposal is to provide a range of possible outcomes at an aggregated level. Other parts of the proposal, such as paragraphs BC58 through BC60, however, suggest that the disclosure should be a sensitivity analysis that determines the magnitude of the change in fair value given a specified change in unobservable inputs, but not necessarily the full range of possible estimates.

It is also not well understood what is meant by correlation. The Background Information and Basis for Conclusions states that the disclosure is not meant to require entities to perform a statistical correlation analysis. But it is not well understood what is meant by correlation if it is not meant to be statistically based. We believe that reporting entities will have difficulty in preparing the required disclosure because the objective and nature of the analysis and the substance of correlation is not clearly defined. Moreover, whether understood in a statistical sense or not, it is not clear that correlation is the right concept in this context. Rather than correlation, we recommend the FASB consider encouraging discussion of relationships between variables when appropriate.

Because of these issues, we question whether the proposal will increase the ability of users of the financial statements to make better, more informed decisions than today when using existing fair value measurement disclosures. For example, reporting entities are currently required to disclose their valuation techniques, inputs to the valuation techniques, and changes to those techniques. The requirement to include a reconciliation of movements in Level 3 fair value measurements by class provides an additional layer of information that can be used to assess the volatility inherent in the measurements. We believe the combination of these disclosures provides useful information for assessing the overall risk and judgment involved in Level 3 fair value measurements. In addition, we are cognizant that excessive disclosure places a cost burden on preparers and of the risk that the totality of the disclosure will become overwhelming, lessening any potential benefit.

Finally, consistent with our response letter to the FASB on the Proposed Accounting Standards Update, *Improving Disclosures about Fair Value Measurements*, we believe this proposed disclosure requirement raises a fundamental question about how management's judgments inherent in estimates should be conveyed within the financial statements. We continue to believe that the uncertainty inherent in estimates is not isolated to fair value measurements, but rather is an issue that applies broadly to all significant management estimates in the financial statements. In our view, the proposed measurement uncertainty analysis would be best considered as part of a broader financial statement disclosure project that would include an overall framework for determining when and how key assumptions and judgments should be captured and conveyed in financial statements. A broader project would enable the Board to devote more time to considering the totality of information provided to users through disclosure and to making an assessment as to what information is most useful to convey about management's judgments and key assumptions. It would also provide an opportunity to consider their placement in either the footnotes to the financial statements or in other areas of financial reporting, such as Management's Discussion and Analysis.

Highest and best use and valuation premise

We are not supportive of the Board's proposal to eliminate the concept of highest and best use and valuation premise for all fair value measurements other than for nonfinancial assets. We note that this



proposal effectively eliminates the aggregation of financial instruments for purposes of determining their fair values when U.S. GAAP defines the unit of account at the level of the individual security.

As a principle, we believe that the financial or nonfinancial nature of an asset being measured at fair value should not affect whether the highest and best use and valuation premise can be applied. Rather, the principle of highest and best use should be available to assets broadly and used when such application results in an appropriate measurement outcome. While financial instruments may not be “used” in combination, they may be “sold” in combination to achieve optimum pricing. For example, a reporting entity may aggregate a Level 3 position in the equity shares of an investee as the sale of the shares in that grouping may be the most efficient means of exit and how market participants are available to transact for the position. This could result in the recognition of “day one gains or losses.” In our experience over the last few years, application of the in-use valuation premise has been the exception rather than the rule. However, in situations where it has been appropriate to group financial or nonfinancial assets, the measurement outcome has, in many cases, been substantively impacted and has better reflected market activities. We thus believe that highest and best use is an important component of valuation, in appropriate circumstances, and it should be available to all assets when supported by appropriate facts.

The unit of account as defined throughout GAAP does not necessarily take into account the manner in which an asset can be sold or is most appropriately valued in the context of an exit price. By requiring that financial assets be valued only at the unit of account level, counter-intuitive results may arise because business practices and market transactions sometimes occur at a level of aggregation that is different from the specified unit of account. The concepts within the existing fair value measurement guidance provide a framework to ensure that measurement at fair value is consistent in that it is based on an exit price and assumptions that market participants would use to value the asset. We believe that imposing a restriction on the application of highest and best use will lead to fair value measurement results that are contrary to the economics of certain transactions and to the principles of fair value measurement, including the market participant concept.

Blockage factors and other premiums and discounts

We believe clarification on the Board’s proposals for blockage factors and other premiums and discounts is needed. While the prohibition on the use of a blockage factor in a fair value measurement that uses a quoted price (a Level 1 fair value measurement) is understood and consistent with existing practice in U.S. GAAP, we believe that the remainder of the proposal on blockage factors (and application of other premiums and discounts to a measurement) is unclear and that the Board should clarify its intent. We believe the ED is vague as to whether and when other premiums and discounts may be applicable in a Level 2 fair value measurement that does not use a quoted price. Paragraph BC41 in the Basis for Conclusions states that reporting entities would apply a premium or discount in a fair value measurement if market participants would take such premium or discount into account when pricing the asset or liability, given the unit of account specified in another Topic. However, the Board also decided not to provide detailed guidance or descriptions so as not to be prescriptive in the application of premiums and discounts. We specifically believe that the proposed changes involving the highest and best use concept and the valuation premise in combination with the proposed changes for blockage factors could have a significant impact on practice.



Although we do not object to the elimination of blockage factors and the substitution of concepts such as control premiums and liquidity discounts, we believe that these concepts should be applied based on valuation premises that align with the facts and circumstances of how these assets can be most efficiently sold to market participants. For example, it is common business practice for reporting entities to apply concentration, liquidity, or other premiums or reserves for “blocks” of holdings of illiquid financial instruments and for certain derivative instruments due to the size of the position. While we understand the Board’s objective of eliminating the ability to apply blockage factors as defined in the ED (i.e., an adjustment to the quoted price for the asset or liability because of the size of the position relative to the trading volume), we believe that other premiums or reserves taken against the calculated fair value to adjust for what the reporting entity believes a market participant would take into account, are appropriate. We suggest the Board clarify that concentration, liquidity, or other premiums or reserves for blocks are acceptable when applied to groupings of financial assets when such adjustments are consistent with business practice and when asset groupings are consistent with the manner in which market participants (or a subgroup of market participants) transact for the asset(s).

Other comments

As the Board redeliberates the proposals and its preliminary decisions, we recommend that it work with the International Accounting Standards Board to reconcile any substantive differences and work to achieve convergence in fair value measurement and disclosure guidance. Our responses to the specific questions on which the Board is seeking comments are included in the Attachment to this letter.

If you have any questions about our comments, please contact Donald Doran (973-236-5280) or Tom McGuinness (973-236-4034).

Sincerely,

A handwritten signature in cursive script that reads "PricewaterhouseCoopers LLP".

PricewaterhouseCoopers LLP



Attachment

PricewaterhouseCoopers LLP's responses to specific questions in the FASB's Proposed Accounting Standards Update, Fair Value Measurements and Disclosures (Topic 820) – Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS

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

Response:

- a. We agree that many of the changes being proposed to existing fair value measurement and disclosure guidance will harmonize the application between U.S. GAAP and IFRS to a large degree by incorporating a common definition of and principles for the application of fair value. However, we are concerned that the proposed amendments will, in some areas, decrease the understandability of existing fair value measurement guidance in U.S. GAAP. As further described in our cover letter and in our responses to the questions that follow herein, we believe there is a lack of clarity in key areas of the proposed guidance, namely with regard to the highest and best use concept and the valuation premise, application of premiums and discounts, and the measurement uncertainty analysis disclosure. Furthermore, the changes being proposed in the areas of highest and best use and the valuation premise as well as premiums and discounts represent fundamental changes in principles that we believe are inconsistent with the economics of affected transactions.

We continue to support the FASB's guidance on the recognition of gains and losses upon an initial fair value measurement ("day one gains and losses") when appropriate, which has been articulated in the ED. We recommend that the Board and International Accounting Standards Board continue to work on reconciling their views in this area to further achieve common fair value measurement guidance.

- b. The lack of clarity surrounding the above key areas of guidance may result in confusion in how the requirements should be applied. We believe that these proposals are likely to result in diversity in practice and therefore a lack of consistency and comparability in reporting. For example, reporting entities may interpret differently how and at what level of detail the measurement uncertainty analysis is to be prepared, what information (e.g., what correlation) is to be included, and how the information is to be presented in the disclosure. See additional details in our cover letter and in our responses to the related questions herein.

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.

Response: We do not believe that the application of the concepts of highest and best use and valuation premise should be limited to nonfinancial assets. Conceptually, we do not see the validity in requiring that a different valuation premise be applied to financial and nonfinancial assets. Rather, individual facts and circumstances, including the principles of exit price and market participant assumptions should determine how the valuation premise is applied. For additional detail, refer to our cover letter.

We are aware of situations in which the concepts of highest and best use and valuation premise can be applied to financial assets. For example, in a business combination they might be applied to financial assets that may constitute part of working capital, or to investment securities that may be purchased at a premium due to the additional value they contribute as a group of assets. In other cases, pools of relatively homogeneous items, such as equity securities, may most economically and efficiently be sold as a pool, rather than on an individual basis. Other circumstances where application of the principal may be appropriate would be for derivative instruments. In the case of derivative instruments that settle physically (e.g., commodity derivatives), reporting entities would be permitted to apply the concept of highest and best use to such instruments since the instruments are nonfinancial. It would seem inconsistent for reporting entities to be precluded from applying highest and best use to the same commodity derivatives, with the only difference being that they have a net settlement provision causing them to fall within the definition of a financial instrument.

We also believe that the issues of highest and best use and unit of account versus unit of measurement are intertwined with the application of blockage factors and premiums and discounts, as further described in our responses to Questions 5 and 6. We offer the examples below to illustrate how the proposed limitation on highest and best use may result in uneconomic measurements:

Example A: Block Discount

Assume a reporting entity owns 15% of the shares of a private company. Plans for a public offering are not presently under discussion and the stock carries a liquidity discount because there is no active or inactive market into which it can be sold. The liquidity discount indicated for a single share of stock is 10% of the per-share market value of the company. The liquidity discount indicated for a block of between 10% and 20% of the outstanding shares of the company is 12%. Shares sold in small lots would result in transaction costs and management time and effort that cause it to be highly inefficient to liquidate on that basis. Any form of liquidation will occur in a bilateral transaction and will involve negotiation with the individual counterparty. Proposed paragraph 820-10-35-36B (in paragraph 50 of the ED) states: "... a reporting entity shall apply a premium or a discount (for example, a control premium or a noncontrolling interest discount) if market participants would consider such a premium or discount when pricing the asset or liability given the unit of account specified in another Topic." The unit of account within the FASB's guidance on accounting for debt and equity investments is the individual share. If the reporting entity measures the shares inclusive of a 10% discount, it will recognize a loss at the time of sale even though it sold the shares in the most economic manner.

Example B: Concentration Premium

Assume the same facts as in Example A, except that the reporting entity pays a premium for the shares because it was able to purchase a large position from a single shareholder. The block



purchase was attractive due to the efficiency of purchasing in large lots and the influence that accompanies a significant investment in an entity with the characteristics of the investee. Similar to the unit of account issue in Example A above, the company considers the guidance for accounting for debt and equity investments, and must make a judgment as to whether it can value the shares inclusive of the concentration premium or if it must value the shares individually as specified within the guidance for accounting for debt and equity investments. Because an individual share does not carry a concentration premium, the reporting entity may conclude that it is required to record a “day 2” loss.

We believe the ED does not provide adequate consideration of the interaction between highest and best use and unit of account and the impact of that interaction on measurement. As a result, if the Board moves forward with the limitation on highest and best use and valuation premise, we recommend the Board clarify that sale in blocks or concentrations may be assumed for financial instruments when it is consistent with the most economic means for selling the asset to market participants and is consistent with market participant behavior.

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?

Response: We agree with the proposed guidance and do not believe that it would result in any significant change in practice under U.S. GAAP for the valuation of instruments classified in shareholders’ equity.

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?
- 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.

Response:

- a. We believe that the proposal is appropriate and will be used by reporting entities. We think that this exception is consistent with the way portfolios are managed and reflects the business purpose of holding security portfolios. However, it is unclear to us why the aggregation of certain financial assets and financial liabilities is appropriate under these circumstances whereas the aggregation of financial assets in a highest and best use concept, which has the same justification as to market participant behaviors and business purpose, is proposed to be precluded.
- b. We believe this exception will generally not change the resulting fair value measurements of financial assets and financial liabilities when they are managed on the basis of the reporting entity’s net exposure to market risks or credit risks.



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 liability (or similar assets or liabilities). Do you think that proposal is appropriate? If not, why not?

Response: We believe the proposal on blockage factors is not clear and will lead to diversity in practice. While the existing fair value measurement guidance is relatively prescriptive by precluding the use of blockage factors for Level 1 fair value measurements, the proposed guidance is confusing and difficult to understand, and will result in practice issues. The clarification proposed by the Board appears to be the elimination of blockage factors as a concept with “rebranding” as premiums and discounts within Levels 2 and 3 fair value measurements. However, because of the proposal for highest and best use and valuation premise, we are skeptical that the application of premiums and discounts would occur in a manner that is consistent with market participant behaviors. As a result, we believe that this proposal will not result in an improvement over the current standard. For more details, refer to our cover letter.

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?
- 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.

Response:

- a. We believe that the proposed guidance on the use of premiums and discounts is not clear. The application of premiums and discounts, such as concentration and liquidity premiums or reserves, should be permitted for “blocks” of holdings of Levels 2 and 3 financial instruments or derivatives due the size of the position, when such premiums or reserves would be taken into account by a market participant and it is the most efficient means of exit. We believe that the Board should clarify that such premiums or discounts would be appropriate. For additional detail, refer to our cover letter.
- b. We believe the unit of account should be based on the asset or liability being measured as specified in the applicable Topic. However, the level at which an asset is aggregated or disaggregated under an exit price concept (unit of valuation) is what determines the fair value and should be done based on consistent principles. While the unit of account within U.S. GAAP may differ from the level of aggregation that may be transacted upon (and therefore valued) by market participants, we believe that the appropriate location within U.S. GAAP for determining valuation on the conceptual merits is within the fair value measurement guidance. The unit of valuation will differ based on the type of investment and the methods and means available for transacting with market participants. Therefore, the conceptual basis for valuation



cannot be appropriately applied solely at the unit of account level, because that level may not represent market participant actions. We believe it is generally specified in U.S. GAAP that for a financial instrument, more often than not, the unit of account is the individual instrument. For that reason, we are concerned that by forcing the application of premiums and discounts at the unit of account level specified elsewhere in GAAP, the valuation of financial instruments will be impacted such that valuation would not be consistent with business practice and the manner in which the instruments are typically traded. For additional detail, refer to our cover letter.

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 this 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?

Response: We do not believe that the proposal currently articulated in the ED is clear, nor will it be cost-beneficial or provide meaningful information for users of the financial statements. The information required is too general and is not meaningful at the aggregated level being proposed. However, it would not be feasible to prepare or present the information on a disaggregated level in any meaningful way. As a result, we do not believe the proposal is appropriate. For additional detail, refer to our cover letter.

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.

Response: As described in our cover letter, we acknowledge that additional information relative to management's judgments and key assumptions may have relevance for certain users of financial statements. However, we think that this proposal would be best considered as part of a broader project on financial statement disclosures.

While we would prefer to consider the issue of additional disclosure as described above, we understand the Board's desire to improve the transparency and decision-usefulness of fair value measurement disclosures. If the Board decides to move forward with additional required disclosures for fair value measurements classified within Level 3 of the fair value hierarchy, we recommend that the FASB consider alternatives such as requiring further descriptions of the inputs pertaining to Level 3 measurements with a specific focus on the ones that are interrelated and carry significant uncertainty, or permitting the use of a value at risk disclosure.

Should the Board decide to require a measurement uncertainty analysis disclosure, we would recommend that such disclosure be required on an annual, not quarterly basis. This should allow for sufficient additional time for reporting entities to prepare the disclosure. The Board also should address the matters raised in our cover letter regarding the aspects of the proposal that are unclear.



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

Response: We do not think the proposal for limited retrospective transition is appropriate. We believe that such transition is inconsistent with prior transition guidance for fair value measurements under U.S. GAAP. Furthermore, we believe a limited retrospective transition for certain aspects of the proposal, if finalized, will place undue burden on reporting entities with limited to no benefit. We do not believe that the cost and complexity associated with the proposed transition guidance would be outweighed by any potential benefits.

Therefore, we suggest that the proposal allow for prospective application. In addition to the conceptual arguments for prospective application, this would allow reporting entities to operationalize the requirements and have the opportunity to accumulate the needed data in time for adoption.

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.

Response: The ED includes links to transition guidance where appropriate (that is, in areas where we believe there may be a change in practice). However, there is one paragraph where we disagree with the conceptual basis. Proposed paragraph 820-10-35-16DD suggests that when estimating the fair value of a liability using the quoted price of the liability held by another entity as an asset, the price of the asset should not be adjusted for any imposed restriction on its sale. We understand that liabilities generally have restrictions on their transfer and as a result agree that those restrictions should not be taken into account in the valuation. However, if the liability is traded as an asset, and that asset has a restriction on its sale that is a characteristic of the asset itself, and not limited to the entity holding the asset, that restriction should adjust the price. The entity purchasing the asset would require compensation (similar to when considering nonperformance risk in a transfer notion) for the sale restriction and therefore, we believe it is relevant to the valuation of the liability, when that liability is valued based on the quoted price of the liability held by another entity as an asset.

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.

Response: We do not believe any of the proposed amendments should be different for nonpublic entities. However, to the extent the effective date may coincide with that of the guidance proposed for the accounting for financial instruments, we would recommend that the transition guidance applicable to nonpublic entities for fair value measurements and disclosures be consistent with that for the new standard on accounting for financial instruments, in order to increase operability.

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



Response: While many of the proposed changes are clarifications to existing guidance, we believe that some could have a significant impact on current practice. Therefore, reporting entities will need to carefully assess the potential impact of the proposed amendments. As described in our response to Question 9, we believe that the implementation of the proposed amendments would require that reporting entities have sufficient time to assess the impact on and integrate these amendments into their systems and processes.

Furthermore, we suggest the Board consider an effective date consistent with the Proposed Accounting Standards Update—*Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*. The two proposals are clearly interrelated and requiring a consistent effective date would aid in reporting entities' ability to operationalize the changes.