new york state society of
NYSSCPA
certified public accountants
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September 7, 2004

Ms. Suzanne Q. Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

By email: director@fasb.org

Re: File Reference 1201-100

Exposure Draft: Proposed Statement of Financial Accounting Standards, *Fair Value Measurements*

Dear Ms. Bielstein:

The New York State Society of Certified Public Accountants, the oldest state accounting association, represents approximately 30,000 CPAs that will implement the provisions proposed in the captioned exposure draft. NYSSCPA thanks FASB for the opportunity to comment on its exposure draft.

The NYSSCPA Financial Accounting Standards and the Investment Management Committees deliberated the exposure draft and prepared the attached comments. If you would like additional discussion with the committee, please contact Robert A. Dyson, chair of the Financial Accounting Standards Committee, at (212) 842-7565, or Robert Colson, NYSSCPA staff, at (212) 719-8350.

Sincerely,

John J. Kearney

John J. Kearney
President

Attachment

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NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON FASB EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards, *Fair Value Measurements*

File Reference No. 1201-100

September 7, 2004

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COMMENTS ON FASB EXPOSURE DRAFT

Proposed Statement of Financial Accounting Standards, Fair Value Measurements

File Reference No. 1201-100

General Comments

Two significant matters require resolution before issuing the proposed standard on fair value measurements. First, FASB should complete its project on relevance and reliability requirements before finalizing the standard on fair value measurements. FASB has not yet presented a convincing case that the fair value measurements in the proposed standard are sufficiently relevant and reliable to provide useful information to financial statement users. The outcomes of the project will affect whether fair value measurements meet the relevance and reliability requirements.

Second, the proposed standard presents numerous concepts that affect a wider range of current pronouncements than is acknowledged in the proposal. The effects of the proposed standard on measurement guidance in existing pronouncements are not clear, and more explanation and additional implementation examples are needed. The theoretical nature of the examples in the proposed standard does not provide sufficient guidance for "real-world" transactions, and obscures any evaluation of the proposed standard's effects on existing pronouncements. The proposed standard, in fact, reads like a concepts statement rather than a statement of financial accounting standards.

Specific Comments

Definition of Fair Value

Issue 1

We agree that the proposed standard's definition of fair value appears adequate. We recommend, however, reconsideration of the proposed valuation techniques because they limit the flexibility in applying the definition to valuation alternatives currently available to reporting entities, as discussed below. In addition, the proposed standard's documentation requirements could be burdensome for financial statement preparers.

Valuation Techniques

Issue 2

The proposal should include additional guidance and examples, particularly for measurements of liabilities using the fair value method. The additional examples are needed to illustrate and clarify both the general guidance and the specific guidance for each concept.

The proposed standard's reference to FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Estimates*, which addresses a single measurement method based on the use of cash flows, is another signal of a movement toward expected cash flow as the most appropriate measurement method. For example, FASB is considering applying the guidance in this proposed standard to an acquired entity in a business combination, as discussed in the *Summary of FASB Tentative Decisions on Business Combinations as of July 27, 2004*. If this is the case, we recommend that this position be exposed for comment, with full analysis of the effect on current financial reporting and on the relevance and reliability of such measurements. As noted in our General Comments, the proposed standard's level of abstraction is closer to a concepts statement than a statement of financial accounting standards. As a result, we question the appropriateness of developing GAAP standards first and then modifying the concepts statements afterwards for compliance rather than using the concepts statements as the framework for GAAP.

Active Markets

Issue 3

While the definition of "active markets" is clear, the relevant guidance is not sufficient for practical application. For example, paragraphs 11 and 12 are helpful but examples applying these concepts are needed. In addition, the concept of "readily available" is not clear. Limiting the example to the New York Stock Exchange (NYSE) to explain the *readily available* and *regularly available* concepts is overly facile and insufficient for other assets. The NYSE example only applies to a narrow range of asset types, and it does not provide examples for measuring property, plant, and equipment or other assets covered in the proposed standard. As a result, the concepts of "ongoing basis" and "sufficient frequency" are not illustrated sufficiently.

In addition, we do not agree with the "one size fits all" philosophy. FASB should consider the utility of information derived from the proposed standard to users of small business financial statements. If applicable, smaller companies should be allowed to use less costly and more efficient approaches.

Valuation Premise

Issue 4

The guidance in Appendix B is generally sufficient for the specific topics it covers. Appendix B, however, does not cover all areas addressed by the proposed standard and needs to be expanded to illustrate such areas as acquired intangible assets or liabilities (commitments) and highly nuanced situations affected by underlying "synergies" involved in a business combination. Realistic and comprehensive examples would alleviate inconsistencies between reporting entities using different valuation techniques for similar assets or liabilities.

Fair Value Hierarchy

Issue 5

The guidance in Appendix B, Example 4, requires clarification, particularly in the last sentence in paragraph B8c. Example 4 should illustrate the process determining the "estimate of fair value ….adjusted as appropriate for the differences, and considered together with the result of other applicable valuation techniques (a Level 3 estimate)."

Level 1 Reference Market

Issue 6

The proposed standard is inconsistent when evaluating the fair value based on the activities of different markets. For example, it excludes explicit costs in retail markets, *e.g.*, commissions, while reflecting implicit liquidity costs, e.g., bid/asked spread, in dealer markets. Both commissions and the bid/asked spread represent compensation to the agent or dealer, but the proposed standard does not justify the different accounting treatment for these similar elements. Fair market value is also influenced by implicit costs, such as market impact (e.g., marketability and block discounts). Additional guidance would be helpful, particularly regarding commodity and arbitrage transactions, including examples of selecting among multiple available markets and details on evaluating level 1 assets. Finally, we are concerned that the evidence required to prepare or audit this information may not be available.

The proposed standard is also inconsistent in addressing transaction costs. The proposed standard should either measure the fair value using guidance in other applicable pronouncements or reflect transaction costs in order to enhance comparability between of the fair value of the assets. Although requiring transaction costs to be accounted for in accordance with the provisions of other applicable pronouncements, generally in the period incurred, the proposed standard considers transaction costs in determining fair value.

For purposes of determining the most advantageous market in arriving at fair value, paragraph 16 requires the consideration of costs to transact in the respective markets; however, the price used to estimate fair value, that is, the price in the most advantageous market, is not adjusted for such transaction costs. This treatment is emphasized in paragraph C26, which asserts that the exchange price used to estimate fair value should not be adjusted for transaction costs that, like the cost to sell in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* include "the incremental direct costs to transact a sale, that is, the costs that result directly from and are essential to a sales transaction and that would not have been incurred by the entity had the decision to sell not been made." This inconsistency must be corrected before issuing the standard.

In addition, Example 5 in Appendix B is not complete. It does not give an example of how to calculate costs when an entity has access to all three markets, A, B, and C. If C is included in the example, different companies could arrive at different answers depending upon the assumptions applied.

In determining the fair value of financial instruments, we recommend the proposed standard should faithfully represent the current brokerage industry practice vis-à-vis pricing. Thus, disposition costs should not be included in retail market exchanges if they are excluded from dealer transactions.

Pricing in Active Dealer Markets

Issue 7

We do not agree with the proposed standard's requirement to estimate fair value of financial instruments traded in an active market using bid prices for long positions, asked prices for short positions, and mid-market for offset positions. This requirement does not reflect the actual economic transactions of dealer and exchange markets, which differ in their pricing considerations. The bid price is not a reliable measure of fair value because it is an expression of interest rather a contracted price. The bid-ask spread is critical in the dealer market because it represents an "exit" price. In paragraph 17, the proposed standard prescribes the mid-point for the matched portion of offsetting positions, but it does not provide guidance on offsetting positions when multiple hedges are applied. The proposed standard is not consistent with the actual market transaction because it assumes that, when an investor decides to terminate an offset position, he or she would sell the long for a price higher than the bid and the short would be covered at a price lower than the asked price.

In addition, the use of bid prices for long positions and asked prices for short positions would result in companies being prohibited from using other methods now considered acceptable by the SEC. While there will be more consistency between companies that are involved in active markets, inconsistencies could still occur if companies differ in how they define active markets. If the closing market price is not used, different companies could arrive at different estimates as to how a post-market event would affect a bid or asked price. Moreover, guidance is necessary for determining when a market is active. For example, a security may trade on each of the first twenty days of a month and then not trade again for another twenty days. In this case, what is the appropriate price to use? Accordingly, we recommend requiring the use of closing market prices in active dealer markets so to promote consistency, but more guidance is required for defining when markets, inactive, or somewhat active. Any after-hours trades would be appropriately reflected in the next day's closing prices.

Market makers that list on the pink sheets are only obligated to buy or sell no more than 100 shares at the quoted prices. Thus, in reality, the listing is more an expression of interest to buy or sell, and the prices listed on pink sheets are not credible. Therefore, anyone desiring to buy or sell more than 100 shares will find the pink sheet bid/ask spread to be utterly meaningless. Moreover, if more than one dealer lists on the pink sheets (again, the legal obligation is for 100 shares only), materially prices different may be quoted, which could result in unreliable measurements if one price is unreasonably high.

If proposed standard ultimately treats offsetting positions differently from non-offsetting positions, clearer guidance is required on accounting for partially offset positions. For example, the proposed standard does not address the measurement of an offset component of an investment if an investor buys a foreign convertible bond, sells short 80 percent of the parity value of the stock into which the bond can be converted, but doesn't hedge the volatility risk and risk-free interest rate embedded in the option component of the bond, the credit risk in the bond, and the foreign exchange risk. The valuation of a security should not depend on whether the security is hedged.

Measurement of Blocks

Issue 8

We disagree with the decision to table the block discount issue. Large block discounts should be taken into account if fair value reflects both explicit and implicit transaction costs (see Issue 6). The block discount issue should be resolved now, because current practice requires different treatments of block discount by the same reporting entity depending on certain timing issues, leading to non-comparable financial statements.

Level 3 Estimates

Issue 9

We found the guidance for Level 3 estimates confusing. Preparers attempting to apply this guidance could equally be confused, which could result in inconsistencies in practice. The examples are sufficient for a conceptual explanation of the proposed standard, but do not provide usable practical guidance because they only refer to fixed assets, and they fail to address assets that are industry specific. In addition, the examples should include the key assumptions that enter into Level 3 estimates and additional information regarding methods used to determine relative value to hypothetical buyers and users.

A key issue is whether the valuation technique that best approximates the exchange price would be used even if the methods were available without undue cost or effort. A decision about the approach to use, together with documenting the reasons for its selection, requires a significant amount of time and effort involving many individual calculations. The complexity of this decision could result in inconsistencies in practice, depending upon the size of the company, the industry, and other factors. Similar companies could use different valuation techniques. The proposed standard could eliminate some of the inconsistencies by designating methods by types of assets with some flexibility allowed and requiring disclosures of major assumptions to reflect various acceptable methods.

The proposed standard should also define the concepts of undue cost and effort in order to limit the ability to avoid the Level 3 approach.

Restricted Securities

Issue 10

The guidance on restricted securities is adequate as far as it goes, but it is too general. The observation in paragraph B19 leaves too much room for manipulation when arriving at a valuation. In concept, restricted securities are no different from large blocks. In fact, restricted securities often are bought at a discount to market value because of the restriction. This discount represents a transaction cost. Similarly, large blocks of securities might be sold at a discount, which reflects the market impact cost. The proposed should be consistent with the final standard covering valuation of stock based compensation.

Fair Value Disclosures

Issue 11

We recommend that qualitative, as opposed to quantitative, analysis be required for disclosures. Disclosures should be meaningful for the users of financial statements. Mere disclosure of categories used will not assist the user in decision making regarding the reasonableness of estimates and assumptions used in deriving the amounts. Disclosures should be substantive (e.g., a qualitative discussion of models, key assumptions, sensitivity analysis, etc.). The proposed standard should provide a comprehensive example showing the changes in presentation and disclosure resulting from issuance of this standard. We recommend that the proposed standard use the approach in the AICPA Investment Company Audit Guide, which presents in paragraph 7.86 an example of how an investment company should disclose its valuation policies in its financial statements.

Effective Date

Issue 12

The timing for implementation is reasonable, especially because, as indicated in paragraph C12, there is no requirement yet to measure assets and liabilities: The proposed standard only modifies existing standards. The proposed standard requires a cumulative-effect adjustment rather than a retroactive restatement approach, but as discussed in the "General Comments," we are concerned about the impact on existing standards.

Small entities would still be exempted from compliance regarding financial instruments under this proposed standard because of the provisions of SFAS 126. For non-financial assets and liabilities, it would only apply to those acquired after June 15, 2005. When fair value is applied using these methods, most companies would use cost to approximate fair value. There is a discrepancy, however, between the date of June 15, 2005 in paragraph 27 and June 15, 2004 in paragraph C68.

Other Issues

Issue 13

It would be helpful if the proposed standard addressed more directly its impact on small entities, as defined in SFAS 126. See our comments under Issue 12.