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Certified Management Accountant Program
Certified in Financial Management Program

November 16, 2005

Mr. Robert H. Herz, Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

Dear Bob:

The Financial Reporting Committee is writing to provide fatal flaw comments on the Staff Draft on *Fair Value Measurements*, which was recently posted to the FASB website. We see several significant issues related to the Staff Draft. We have attached our prior letter that outlines our significant concerns regarding the marketplace participants approach. We also have concerns with new guidance added after the issuance of the Exposure Draft that relate to transaction costs and proposed disclosures. Each of these matters is discussed below.

Marketplace Participants Approach

We request that the Board reconsider its decision to require broad application of the marketplace participants approach. It appears that the FASB has dismissed the issues we raised in our July 5, 2005 letter. That said, the Board also has failed to provide any guidance on how assets measured under a marketplace participants view should be measured on Day 2. We expect that will be a significant issue for companies that acquire assets in a business combination that they intend to abandon. Paragraph C59 of the Basis for Conclusions states, in part:

The Board understands that a multi-period excess earnings method is used to estimate the fair value of certain intangible assets acquired in a business combination. The Board agreed that the method should continue to be used under this Statement. However, the Board observed that the related guidance in the Practice Aid could be interpreted to require an estimate using an in-exchange valuation premise in situations in which marketplace participants would continue to use an asset that the entity does not intend to use. For example, that might be the case if an entity (acquirer) intends to abandon certain proprietary assets that marketplace participants would continue to use. The Board agreed that consistent with the related guidance in this Statement, the estimate should be considered from the perspective of marketplace participants and developed using an in-use valuation premise, where appropriate.

This view is supplemented in paragraph C32 of the Staff Draft, which states:

A few respondents also questioned the interaction between an in-use valuation premise and the exchange notion encompassed within the definition of fair value. In response, the Board clarified that in situations in which the highest and best use of an asset is in-use, an in-use valuation premise focuses the estimate on an exchange that involves an asset group (the asset is installed or otherwise configured for use). Because highest and best use is considered from the perspective of marketplace participants, the estimate is a market-based estimate that reflects the consensus view of marketplace participants with respect to the asset. It is not an entity-specific estimate that reflects the entity's own expectations with respect to the asset.

We observe that hypothetical values derived using the marketplace participants approach would appear to be irrelevant, as the resulting assets will actually produce no cash flows. The Board seems to care relatively more about comparability of measures across enterprises (e.g., the asset should be measured the same, no matter who the purchaser is) at the expense of the relevance of the purchaser's financial statements. Specifically, the Board does not appear to mind that the asset recognized is not really an asset to the purchaser. As we noted in our previous letter, this creates a tremendous disconnect between the accounting and the underlying economics.

Given this disconnect, there also will be significant issues with the subsequent accounting. If an acquired asset is to be abandoned and will never be sold or used by the purchaser, what assumptions should be made in order to do the day 2 accounting? From our perspective, all of the available alternatives are equally unpalatable. Most constituents would believe that the asset should be impaired immediately, as the sum of the undiscounted expected cash flows is zero. Others believe that once one adopts the marketplace participants approach, that model has to be applied consistently to future measurements by assuming the actions that would be taken by the hypothetical acquirer in continuing to operate and (presumably) invest in the asset. This leaves preparers in the position of defending assumptions that, in the Committee's view, can only be described as extreme speculation. A third alternative would be to amortize the asset over some hypothetical market place participant's anticipated economic life to a hypothetical salvage value, if any. Like the fair value measurement itself, we believe the assumptions are likely to be largely arbitrary because they would require assumptions about what the hypothetical purchaser would do with the asset post-acquisition (e.g., how long that party would continue to reinvest in the asset and how big those investments might be).

Transaction Costs

We note that paragraph 14 was not included in the June 2004 ED and will have significant impact on existing practices. That paragraph states that direct incremental transaction costs are not part of the reference market price for an asset or liability, except for transportation costs necessary to access the market (an exception meant to allow market prices for commodities to reflect transportation costs so as not to require an immediate write-down). We interpret this new guidance as an expansion of the scope of the proposed standard, which originally appeared to address only exit values (and thereby, the exclusion of transaction costs from exit fair values). Either we are confused by the revised guidance (i.e., it is not the Board's intention to prescribe an entrance fair value that excludes transaction costs) or the Board has expanded the application of the guidance significantly subsequent to the issuance of the ED. If the latter, this will have significant effects on the accounting for a broad range of assets (installation costs for fixed

assets, sales/VAT taxes on assets acquired, debt and equity underwriting costs, etc). While the new ED cleverly indicates that transaction costs should be accounted for in accordance with the provisions of other applicable GAAP, this paragraph (which is entirely consistent with the treatment of transaction costs for Business Combinations ED), establishes a precedent for all future standards. As noted in our comment letter response to the latter ED, we strongly disagree with required expensing of transaction costs, for the reasons noted therein. We think that this represents a very significant modification to the ED that has not been exposed for public comment.

Disclosures

The disclosure requirements outlined in paragraphs 35 and 36 will require a level of disclosure that is clearly not sustainable over the long term. We question whether it will be feasible to provide the level of disclosure required for interim periods and still meet the accelerated filing requirements, especially with respect to the level 3-5 fair value measures that would flow from "day 2 accounting" for business combinations, asset retirement obligations and potentially other standards. We believe the Board needs to take a step back and consider these requirements in the context of the burdens already place on companies. Clearly all of this information is not vital to investors.

We suspect that many constituents are completely unaware of the changes in the ED regarding marketplace participants and transaction costs. We also expect that they would have wanted to comment on this principle. We therefore suggest that the Board not finalize this standard until these issues have been discussed in a public forum (e.g., a roundtable or other meeting) and that it consider issuing a revised exposure draft that would enable the it to receive views of constituents on these changes. We welcome the opportunity to discuss these views further at your convenience. I can be reached at (513) 983-3874.

Sincerely,

Teri List
Chair, Financial Reporting Committee
Institute of Management Accountants