FOR IMMEDIATE RELEASE **2008-234**

SEC OFFICE OF THE CHIEF ACCOUNTANT AND FASB STAFF CLARIFICATIONS ON FAIR VALUE ACCOUNTING

Washington, D.C., Sept. 30, 2008 – The current environment has made questions surrounding the determination of fair value particularly challenging for preparers, auditors, and users of financial information. The SEC's Office of the Chief Accountant and the staff of the FASB have been engaged in extensive consultations with participants in the capital markets, including investors, preparers, and auditors, on the application of fair value measurements in the current market environment.

There are a number of practice issues where there is a need for immediate additional guidance. The SEC's Office of the Chief Accountant recognizes and supports the productive efforts of the FASB and the IASB on these issues, including the IASB Expert Advisory Panel's Sept. 16, 2008 draft document, the work of the FASB's Valuation Resource Group, and the IASB's upcoming meeting on the credit crisis. To provide additional guidance on these and other issues surrounding fair value measurements, the FASB is preparing to propose additional interpretative guidance on fair value measurement under U.S. GAAP later this week.

While the FASB is preparing to provide additional interpretative guidance, SEC staff and FASB staff are seeking to assist preparers and auditors by providing immediate clarifications. The clarifications SEC staff and FASB staff are jointly providing today, based on the fair value measurement guidance in FASB Statement No. 157, Fair Value Measurements (Statement 157), are intended to help preparers, auditors, and investors address fair value measurement questions that have been cited as most urgent in the current environment.

* * *

Can management's internal assumptions (e.g., expected cash flows) be used to measure fair value when relevant market evidence does not exist?

Yes. When an active market for a security does not exist, the use of management estimates that incorporate current market participant expectations of future cash flows, and include appropriate risk premiums, is acceptable. Statement 157 discusses a range of information and valuation techniques that a reasonable preparer might use to estimate fair value when relevant market data may be unavailable, which may be the case during this period of market uncertainty. This can, in appropriate circumstances, include expected cash flows from an asset. Further, in some cases using unobservable inputs (level 3) might be more appropriate than using observable inputs (level 2); for example, when significant adjustments are required to available observable inputs it may be appropriate to utilize an estimate based primarily on unobservable inputs. The determination of fair value often requires significant judgment. In some cases, multiple inputs from different sources may collectively provide the best evidence of fair value. In these cases expected cash flows would be considered alongside other relevant information. The weighting of the inputs in the fair value estimate will depend on the extent to which they provide information about the value of an asset or liability and are relevant in developing a reasonable estimate.

How should the use of "market" quotes (e.g., broker quotes or information from a pricing service) be considered when assessing the mix of information available to measure fair value?

Broker quotes may be an input when measuring fair value, but are not necessarily determinative if an active market does not exist for the security. In a liquid market, a broker quote should reflect market information from actual transactions. However, when markets are less active, brokers may rely more on models with inputs based on the information available only to the broker. In weighing a broker quote as an input to fair value, an entity should place less reliance on quotes that do not reflect the result of market transactions. Further, the nature of the quote (e.g. whether the quote is an indicative price or a binding offer) should be considered when weighing the available evidence.

Are transactions that are determined to be disorderly representative of fair value? When is a distressed (disorderly) sale indicative of fair value?

The results of disorderly transactions are not determinative when measuring fair value. The concept of a fair value measurement assumes an orderly transaction between market participants. An orderly transaction is one that involves market participants that are willing to transact and allows for adequate exposure to the market. Distressed or forced liquidation sales are not orderly transactions, and thus the fact that a transaction is distressed or forced should be considered when weighing the available evidence. Determining whether a particular transaction is forced or disorderly requires judgment.

Can transactions in an inactive market affect fair value measurements?

Yes. A quoted market price in an active market for the identical asset is most representative of fair value and thus is required to be used (generally without adjustment). Transactions in inactive markets may be inputs when measuring fair value, but would likely not be determinative. If they are orderly, transactions should be considered in management's estimate of fair value. However, if prices in an inactive market do not reflect current prices for the same or similar assets, adjustments may be necessary to arrive at fair value.

A significant increase in the spread between the amount sellers are "asking" and the price that buyers are "bidding," or the presence of a relatively small number of "bidding" parties, are indicators that should be considered in determining whether a market is inactive. The determination of whether a market is active or not requires judgment.

What factors should be considered in determining whether an investment is other-than-temporarily impaired?

In general, the greater the decline in value, the greater the period of time until anticipated recovery, and the longer the period of time that a decline has existed, the greater the level of evidence necessary to reach a conclusion that an other-than-temporary decline has not occurred.

Determining whether impairment is other-than-temporary is a matter that often requires the exercise of reasonable judgment based upon the specific facts and circumstances of each investment. This includes an assessment of the nature of the underlying investment (for example, whether the security is debt, equity or a hybrid) which may have an impact on a holder's ability to assess the probability of recovery.

Existing U.S. GAAP does not provide "bright lines" or "safe harbors" in making a judgment about other-than-temporary impairments. However, "rules of thumb" that consider the nature of the underlying investment can be useful tools for management and auditors in identifying securities that warrant a higher level of evaluation.

To assist in making this judgment, SAB Topic 5M[1] provides a number of factors that should be considered. These factors are not all inclusive of the potential factors that may be considered individually, or in combination with other factors, when considering whether an other-than-temporary impairment exists. Factors to consider include the following:

- The length of the time and the extent to which the market value has been less than cost;
- The financial condition and near-term prospects of the issuer, including any specific events, which may influence the operations of the issuer such as changes in technology that impair the earnings potential of the investment or the discontinuation of a segment of the business that may affect the future earnings potential; or
- The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.

All available information should be considered in estimating the anticipated recovery period.

* * *

Finally, because fair value measurements and the assessment of impairment may require significant judgments, clear and transparent disclosures are critical to providing investors with an understanding of the judgments made by management. In addition to the disclosures required under existing U.S. GAAP, including Statement 157, the SEC's Division of Corporation Finance recently issued letters in March and September that are available on the SEC's Web site to provide real-time guidance for issuers to consider in enhancing the transparency of fair value measurements to investors. Additionally, the SEC staff and the FASB staff will continue to consult with capital market participants on issues encountered in the application of fair value measurements.

# # #

[1] AU 332, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*, of the PCAOB Interim Auditing Standards also provide factors to consider when evaluating whether an impairment is other-than-temporary.