



## U.S. Securities and Exchange Commission

### Sample Letter Sent to Public Companies on MD&A Disclosure Regarding the Application of SFAS 157 (Fair Value Measurements)

In September 2008, the Division of Corporation Finance sent the following illustrative letter to certain public companies identifying a number of disclosure issues they may wish to consider in preparing Management's Discussion and Analysis.

September 2008

Name  
Chief Financial Officer  
XYZ Corporation  
Address

Dear Chief Financial Officer:

In March 2008 we sent you a letter in which we highlighted a number of disclosure issues relating to fair value measurements we thought you may wish to consider as you prepare your quarterly Management's Discussion and Analysis of Financial Condition and Results of Operations. You can find a sample copy of this letter on the SEC web site at [www.sec.gov/divisions/corpfin/guidance/fairvalueltr0308.htm](http://www.sec.gov/divisions/corpfin/guidance/fairvalueltr0308.htm).

You should continue to evaluate whether you could provide clearer and more transparent disclosure regarding your fair value measurements, particularly with regard to financial instruments that are not currently actively traded and whose effects have had, or are reasonably likely to have, a material effect on your financial condition or results of operations. Specifically, information about the judgments and assumptions underlying your fair value measurements, the sensitivity of your measurements to those assumptions, and details about the methodology and inputs you used can help investors better understand your accounting and disclosure.

To the extent material to your own facts and circumstances, you may wish to consider the following additional fair value measurement disclosure items in your Management's Discussion and Analysis.

- The significant judgments you made in classifying a particular financial instrument in the fair value hierarchy.
- An explanation of how credit risk is incorporated and considered in the valuation of assets or liabilities — whether under SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, or other applicable standards.

- SFAS 159 requires you to provide disclosure about the gain/loss on items you elect to carry at fair value but not on those items you are required to carry at fair value — such as derivative instruments accounted for under SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*. If material to your results of operations, consider disclosing the gains or losses on financial instruments that you are required to carry at fair value and explain:
  - How your credit risk affected your valuation of derivative liabilities and the resulting gain or loss that you included in earnings relating to the changes in that credit risk; and
  - How counterparty credit risk affected your valuation of derivative assets and the resulting gain or loss that you included in earnings relating to the changes in that credit risk. Also, consider discussing how deterioration in the counterparty's credit and your ability to collect on a derivative asset will impact your financial statements.

The location of this information can facilitate an understanding of the impact on the financial statements. Accordingly, you may want to discuss the implications of items you elect to carry at fair value with the items that you are required to carry at fair value.

- The criteria you used to determine whether the market for a financial instrument is active or inactive (i.e., illiquid).
- Which financial instruments are affected by the lack of market liquidity (i.e. inactivity), how the lack of liquidity impacted the valuation technique you used, and how you factored illiquidity into your fair value determination of those financial instruments. For example, to the extent you used a discounted cash flow approach to determine the fair value of a financial instrument, such as auction rate securities, loans held for sale, or mortgage-backed securities backed by subprime or Alt-A collateral, consider discussing the specific change in the discount rate or any other analysis you performed to account for the lack of liquidity and discuss how and why you changed your assumptions from prior periods.
- If you disclose that you use brokers or pricing services to assist you in determining fair values, consider explaining the extent to which, and how, the information is obtained and used in developing the fair value measurements in the consolidated financial statements. The nature and form of this information may vary depending on the facts and circumstances, but may include the following:
  - The nature and amount of assets you valued using broker quotes or prices you obtained from pricing services, along with the classification in the fair value hierarchy;
  - The number of quotes or prices you generally obtained per instrument, and if you obtained multiple quotes or prices, how you determined the ultimate value you used in your financial statements;
  - Whether, and if so, how and why, you adjusted quotes or prices you obtained from brokers and pricing services;
  - The extent to which the brokers or pricing services are gathering

observable market information as opposed to using unobservable inputs and/or proprietary models in making valuation judgments and determinations;

- Whether the broker quotes are binding or non-binding; and
- The procedures you performed to validate the prices you obtained to ensure the fair value determination is consistent with SFAS 157, *Fair Value Measurements*, and to ensure that you properly classified your assets and liabilities in the fair value hierarchy.

Please contact me if you have any questions.

Sincerely,

Senior Assistant Chief Accountant

<http://www.sec.gov/divisions/corpfin/guidance/fairvalueltr0908.htm>