

Heads Up

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Valuation Resource Group Discusses Four Topics at February 5 Meeting.

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The Valuation Resource Group (VRG) was established to provide the FASB staff with information about implementation issues regarding fair value measurements used in financial reporting and the alternative viewpoints associated with those implementation issues. The VRG is composed of a cross-section of industry representatives, including financial statement preparers, auditors, users, and valuation experts. VRG meetings are coordinated by the FASB staff and observed by the SEC, the AICPA, and the PCAOB. Although these meetings have historically not been open to the public, the February 5, 2009, meeting included a nonpublic meeting followed by a public meeting with the FASB. The views expressed at the VRG meeting are not authoritative decisions. Authoritative decisions are subject to the FASB's normal, open due process, including open deliberation by the Board.

Greg Forsythe is Deloitte's representative on the VRG. Sam Loughry and Beth Ann Reese observed the meeting. The notes below represent the authors' interpretations of the discussions held at the February 5, 2009, VRG meeting. The views expressed are not necessarily the views of the authors or of Deloitte. For technical interpretations of Statement 157¹ and other accounting literature, visit Technical Library: The Deloitte Accounting Research Tool, and consider contacting the appropriate accounting or valuation professional.

Meeting Discussion Notes

VRG Issue No. 2009-1: SEC's Study on Mark-to-Market Accounting

Background: On December 30, 2008, the SEC submitted to Congress a detailed report and recommendations regarding mark-to-market (MtM) accounting (the "report").² The report responds to the congressional mandate in Section 133 of the Emergency Economic Stabilization Act of 2008 that the SEC conduct a study on MtM accounting standards in consultation with the Federal Reserve Board and the secretary of the Treasury. The report concludes that existing MtM or fair value accounting requirements should not be suspended and recommends measures to improve the application of such requirements. The FASB staff asked for input from the VRG on several of these recommendations.

Editor's Note: For additional information about the SEC's MtM report, see Deloitte's [January 9, 2009, Heads Up](#).

¹ FASB Statement No. 157, *Fair Value Measurements*.

² The study, "Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting," is available on the [SEC's Web site](#).

Question 1: The VRG was asked what additional guidance should be developed on determining (1) when a market becomes inactive and (2) whether a transaction is distressed.

Discussion: The VRG indicated that because of the difficulty in identifying inactive markets, entities tend to favor using the most recent transaction when measuring assets at fair value. Some VRG members indicated that this is because observable transactions generally provide high-quality, auditable evidence of fair value that is supported by the Statement 157 fair value hierarchy. Several members indicated that although the recently issued FSP FAS 157-3³ contains some guidance on when to move away from using the last transaction price as the only input to a fair value measurement, additional guidance on determining when a market becomes inactive would be helpful.

Most VRG members indicated that the factors in the IASB's [Expert Advisory Panel \(EAP\) paper](#)⁴ for determining whether a market is active or inactive are useful and should be codified as authoritative guidance. The VRG indicated that additional guidance or examples would be useful in the following areas: (1) the amount of time involved, or assumed to be involved, in the sales process; (2) an entity's ability to execute, or probability of executing, a transaction at a particular price; and (3) differences in classification of inputs between Level 2 and Level 3.

VRG members noted that it is generally difficult to find persuasive evidence of an individual transaction's being distressed and that additional guidance is needed on when a distressed market may lead to a distressed transaction. Members also indicated that the factors in the IASB's EAP paper were helpful in describing characteristics of a forced or distressed transaction.

Question 2: The VRG was asked about the feasibility of separating changes in fair value into changes due to credit and changes due to liquidity.

Discussion: Many VRG members agreed that separating liquidity and credit risk would be complicated and costly to implement. They questioned the value of this information to investors. Some VRG members recommended that realized losses be classified in earnings and that unrealized losses be classified in other comprehensive income. They also recommended conducting a study of what investors would like to see separated out in the financial statements.

Question 3: The VRG was asked what additional disclosures were needed about fair value.

Discussion: The VRG members that represented financial statement users identified several disclosures that would be beneficial, including (1) tabular disclosures of the carrying amount, fair value, and some measure of economic loss for debt securities and loans receivable; (2) information regarding the significant inputs used in fair value measurements; (3) a sensitivity analysis of the significant inputs in a fair value measurement; and (4) the method an entity uses to determine that a transaction is inactive or distressed. These members indicated that an entity should provide these disclosures on both an interim and an annual basis.

Editor's Note: The first suggested disclosure above is similar to that included in proposed FSP FAS 107-a, which the Board rejected at its January 23, 2009, meeting. The other disclosures were also discussed at the September 23, 2008, VRG meeting. For more information, see Deloitte's [October 8, 2008, Heads Up](#).

Question 4: The VRG was asked whether incorporation of an entity's own credit risk into a fair value measurement of a liability is decision-useful information for investors.

Discussion: Several VRG members noted that analysts typically back out gains or losses recognized in the income statement for adjustments to debt that reflect changes to an entity's own credit risk. Analysts also consider adjustments to derivative liabilities that result from changes in a company's own credit.

³ FASB Staff Position No. FAS 157-3, "Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active."

⁴ IASB Expert Advisory Panel Final Report, *Measuring and Disclosing the Fair Value of Financial Instruments in Markets That Are No Longer Active*.

VRG Issue No. 2009-2: Proposed FSP FAS 157-c, "Measuring Liabilities Under FASB Statement No. 157"

Background: The exit price concept for measuring liabilities under Statement 157 assumes that (1) the liability is transferred to a market participant as of the measurement date and is not settled with the counterparty and (2) the nonperformance risks associated with that liability are the same before and after its transfer. Preparers have noted that it is difficult to apply this concept to liabilities since exit markets to transfer liabilities generally do not exist because most liabilities contain transfer restrictions.

The Board instructed the FASB staff to provide clarifying guidance to help preparers develop fair value measurements for liabilities. The Board first discussed proposed FSP FAS 157-c at its April 9, 2008, meeting. At that meeting, Board members expressed significantly differing views about what direction the project should take, but agreed that guidance was necessary. Some Board members supported issuing the proposed FSP, while others questioned whether fair value was the appropriate measurement attribute for restricted liabilities. The Board asked the staff to revise the proposed FSP for further discussion on the basis of the input it received at the Board meeting. The staff presented the updated draft of the proposed FSP to the VRG for feedback.

Editor's Note: The staff plans to present the updated proposed FSP FAS 157-c at the Board meeting on February 25, 2009. We expect that the proposed FSP will be publicly reexposed at some point after that meeting.

Question: The VRG was asked whether it agrees with the updated proposed FSP.

Discussion: The VRG noted that the draft proposed FSP would allow entities measuring a liability for which the asset is traded in an active market to use the quoted market price of the asset as an input to the fair value measurement of the liability. The staff emphasized that the fair value of the traded asset is an input to a fair value measurement of a liability and that this input may sometimes need to be adjusted. However, the staff indicated that it does not believe it is necessary to make an adjustment to reflect the existence of a legal restriction preventing the transfer of the liability. The staff stated that the value of the restriction would already be included in the rate of return of the asset and that because most liabilities contain this restriction, comparability would only be affected if an adjustment were made.

The VRG agreed that there would generally be symmetry between the measurement of the asset and the related liability. The VRG indicated that financial statement preparers may benefit from guidance on when symmetrical measurements would not be appropriate. One example discussed was the measurement of a liability with a third-party credit enhancement feature such as a guarantee. Members also indicated that the staff should consider whether certain features of an obligating instrument, such as debt with put or call features, would create asymmetry.

Several VRG members questioned the scope of the proposed FSP, which applies to all liabilities. Those members indicated that the guidance in the proposed FSP would be helpful for measuring the fair value of debt but probably not for measuring the fair value of certain derivatives, which can be either assets or liabilities. Others questioned whether fair value is the appropriate measurement attribute for liabilities that are not exchange-traded.

VRG Issue No. 2009-3: AICPA Draft Issues Paper, "FASB Statement No. 157 Valuation Considerations for Interests in Alternative Investments"

Background: The AICPA Accounting Standards Executive Committee and the Alternative Investments Task Force (AITF) prepared a [draft issues paper](#) on valuation considerations for interests in alternative investments. This nonauthoritative draft paper provides initial views on estimating the fair value of alternative investments in accordance with Statement 157, including the role of net asset value (NAV) in estimating fair value.

Question: The VRG was asked whether it agreed with the conclusions reached in the draft paper and whether it covered certain items that the FASB should address through additional standard setting.

Discussion: A VRG member who is on the AITF indicated that views differ about the principal market for alternative investments, such as hedge funds and private equity funds. Some believe that the principal market is transactions with the general partner of the fund, while others believe it is transactions in the secondary market. The draft paper takes the point of view that the secondary market is the principal market. The draft paper asserts that in the absence of an observable transaction in the secondary market, the holder of the investment can use the NAV provided by the general partner as a starting point when measuring fair value.

The VRG discussed guidance that would allow the use of NAV as a practical expedient. Some questioned providing a practical expedient for measurement of alternative investments with restrictions and the effect that would have on fair value measurements of other assets with restrictions. Other VRG and Board members questioned whether fair value was the appropriate measurement attribute for alternative investments that have exit restrictions as of the measurement date. The VRG concluded that authoritative guidance would be helpful in this area.

VRG Issue No. 2009-4: Goodwill Impairment Considerations

Background: At the 2008 AICPA National Conference on Current SEC and PCAOB Developments, an SEC staff member acknowledged that given the recent market decline, the SEC staff is expecting to see “more goodwill impairments than in prior years.” The staff indicated that when performing a goodwill impairment analysis, it would be “prudent” for an entity to reconcile its market capitalization to the aggregate fair value of its reporting units. The staff indicated that one of the differences in the reconciliation is a “control premium.” This is acknowledged in paragraph 23 of Statement 142,⁵ which states that “an entity might derive ‘substantial value’ from the ability to obtain control.”

Editor’s Note: For more details about the SEC staff’s comments on goodwill testing at the 2008 AICPA Conference, see Deloitte’s [December 18, 2008, Heads Up](#).

Question: The VRG was asked whether the SEC staff’s comments sufficiently address practice issues with the market capitalization reconciliation and control premiums.

Discussion: The VRG indicated that the SEC’s comments were helpful but that it is hard to provide guidance on this topic because each analysis depends on an entity’s specific facts and circumstances. VRG members noted that, in practice, many entities arbitrarily explain the difference between market capitalization and aggregate fair value of the reporting units estimated by using a discounted cash flow model as a control premium. The members agreed that the term “control premium” is misunderstood and that additional education about this concept is necessary. Such education would include information about why a difference between market capitalization and a transaction price (whether actual or hypothetical) exists. Most members believed that additional guidance should come from the valuation community rather than from the FASB. The Appraisal Foundation is considering forming a working group to take on this topic and to provide additional guidance.

⁵ FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

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