

Defining Issues[®]

KPMG LLP



Alert

©2001-2009 KPMG LLP, a U.S. limited liability partnership and a member firm of the network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. 21147NSS

Photo: GettyImages/Stone/Simon Ladefoged 200138209-001

FASB Proposal to Expand Disclosures about Fair-Value Measurements

Reporting entities would be required to disclose information about how alternative inputs could affect their fair-value measurements as well as additional information about their fair-value measurements, all at a greater level of disaggregation, if a new FASB proposal is adopted without change.¹ The additional disclosures would include information about the effect of “reasonably possible” alternative Level 3 inputs and transfers in and/or out of the Level 1 and 2 categories of inputs, increased disclosures of activity in Level 3 fair-value measurements, and other disclosures about inputs and valuation techniques.

The proposal would apply to all entities that provide disclosures about fair-value measurements under U.S. GAAP.² Most of the proposed disclosure requirements would be effective for interim and annual reporting periods ending after December 15, 2009. The sensitivity disclosures for Level 3 fair-value measurements would be effective for interim and annual periods ending after March 15, 2010.

Comments on the proposal are due October 12, 2009.

If the proposal is adopted, it will more closely align the fair-value disclosures required by U.S. GAAP with those required by International Financial Reporting Standards.

Greater Level of Disaggregation

The proposal would require disclosures of fair-value measurements by “class,” as opposed to the currently required “major category” approach. A class is generally a subset of assets or liabilities within a line item in the statement of financial position.

The class for debt and equity securities would correspond to the GAAP description of “major security type” that financial institutions are required to use in disclosing information about their investments in debt and equity securities, even if the entities or securities are not within

¹ FASB Proposed Accounting Standards Update, Improving Disclosures about Fair Value Measurements, available at www.fasb.org.

² FASB ASC Topic 820, Fair Value Measurements and Disclosures, available at www.fasb.org.

the scope of those requirements.³ The classes of all other assets and liabilities would be determined by judgment that reflects consideration of both

- The nature and risks of the assets and liabilities and their placement in the fair value hierarchy and
- The level of disaggregation already required under other GAAP.

It is generally expected that fair-value measurements using significant unobservable inputs (Level 3 fair-value measurements) would have a greater number of classes because they have a higher degree of uncertainty and subjectivity. The proposal would require that the disclosures by class contain sufficient information to allow the fair-value-measurement disclosures for the various classes of assets and liabilities to be reconciled to the line items in the balance sheet.

Effect of “Reasonably Possible” Alternative Level 3 Inputs

The most significant potential change to existing fair-value disclosures is the proposed disclosure of the effects of “reasonably possible” alternative Level 3 inputs. The proposed requirement would apply to each class of fair-value measurements using significant unobservable inputs (Level 3). If a change in one or more of the significant inputs to “reasonably possible” alternative inputs would increase or decrease the fair value significantly, the reporting entity would be required to state that fact and disclose the effect of the changes. The definition of “reasonably possible” is: “The chance of the future event or events occurring is more than remote but less than likely.”⁴

To comply with these disclosure requirements, reporting entities would first need to determine which of their Level 3 inputs have reasonably possible alternative inputs that could have been used instead of the inputs that were used in performing the fair-value measurement. In identifying the reasonably possible alternative inputs, an entity would have to consider the current economic environment in which it operates. Reporting entities would then need to determine which inputs, if changed to a reasonably possible alternative, would significantly affect the fair-value measurement. Significance would be judged with respect to earnings and total assets or total liabilities, or, when changes in fair values are recognized in other comprehensive income, with respect to total equity. The next step would be to perform calculations based on different combinations of the identified reasonably possible inputs in order to determine a range of values that could have been calculated for reporting purposes. Finally, reporting entities would have to disclose the fair-value measurements of each class of its Level 3 assets and liabilities recorded in the financial statements and the range determined from the use of reasonably possible alternative inputs.

This disclosure requirement would apply to all assets and liabilities measured at fair value whether on a recurring or on a nonrecurring basis. However, the requirement would not apply to Level 3 fair-value measurements that are within the scope of the FASB’s proposed guidance on investments in investment companies that are reported at net asset values.⁵

The proposal does not specify a method that would have to be used to calculate the effect of reasonably possible alternative inputs, but it would require the method that is used to

³ FASB ASC Topic 942, Financial Services – Depository and Lending, paragraph 942-320-50-2, available at www.fasb.org.

⁴ FASB ASC Topic 450, Contingencies, available at www.fasb.org.

⁵ Proposed FASB Staff Position No. FAS 157-g, Estimating the Fair Value of Investments in Investment Companies That Have Calculated Net Asset Value per Share in Accordance with the AICPA Audit and Accounting Guide, Investment Companies, June 8, 2009, available at www.fasb.org.

be disclosed. It would also require that the disclosures about significant inputs to Level 3 fair-value measurements and reasonably possible alternative inputs be quantitative. The proposal says that the sensitivity information is not intended to represent a remote or worst-case scenario.

The proposal acknowledges that SEC registrants may currently be required to provide sensitivity information in Management's Discussion and Analysis. However, the MD&A sensitivity information is different from what the FASB has proposed for disclosure, and the FASB believes that a GAAP requirement to disclose sensitivity information would be useful because the information would be presented in the audited financial statements.

We expect this proposal on "reasonably possible" alternative Level 3 inputs to be a focal point for comments from constituents.

Disclosures of Transfers In and/or Out of Levels 1 and 2

GAAP currently requires reporting entities to disclose transfers of assets and liabilities in and/or out of the Level 3 category in the fair value hierarchy.⁶ The proposal would require reporting entities to disclose information about significant transfers in and/or out of the Level 1 and 2 categories, in addition to disclosing the transfers for the Level 3 category. The transfers into each level and the transfers out of each level would have to be separately presented. Significance would be judged with respect to earnings and total assets or total liabilities or, if changes in fair values are recognized in other comprehensive income, with respect to total equity. Significant transfers would be presumed to have occurred at the beginning of the reporting period.

The reasons for transfers in and/or out of the levels of the fair value hierarchy would have to be disclosed, a requirement that would apply to transfers in and/or out of any of the three levels.

Activity in Level 3 Fair-Value Measurements

Reporting entities are already required to disclose purchases, sales, issuances, and settlements of assets and liabilities categorized as Level 3 fair-value measurements on a net basis.⁷ The proposal would require these activities to be disclosed separately.

Other Disclosures about Inputs and Valuation Techniques

Reporting entities would have to disclose, for each class of asset or liability subject to fair-value measurement, the valuation techniques and inputs used to determine fair value, if the measurement used significant other observable inputs or significant unobservable inputs (Level 2 or Level 3 fair-value measurements). These disclosure requirements would apply to all assets and liabilities measured at fair value whether on a recurring or on a nonrecurring basis. Changes in valuation techniques used (e.g., from a market to an income approach) and the reasons for the changes would also have to be disclosed.

Application to Derivative Instruments

GAAP for derivative instruments currently requires that the fair values be disclosed, segregated between assets and liabilities.⁸ The proposed requirements would be consistent with current GAAP requirements. Companies would be required to provide class-level disclosures of fair

⁶ FASB ASC Topic 820, Fair Value Measurements and Disclosures, available at www.fasb.org.

⁷ FASB ASC Topic 820, Fair Value Measurements and Disclosures, available at www.fasb.org.

⁸ FASB ASC Topic 815, Derivatives and Hedging, available at www.fasb.org.



values at the reporting date, location within the fair value hierarchy, and significant transfers between levels on a gross basis. However, the proposal would permit disclosure on a net basis for the rollforward disclosures of activity in Level 3 assets and liabilities and the disclosure of gains and losses for the period included in earnings that are attributable to assets and liabilities still held at the reporting date.

Effective Date and Transition

Most of the proposed disclosure requirements would be effective for interim and annual reporting periods ending after December 15, 2009. However, the disclosures of the effects of reasonably possible alternative inputs would be required for interim and annual reporting periods ending after March 15, 2010. Retroactive application to comparative periods prior to the adoption date would not be required.

The descriptive and summary statements in this newsletter are not intended to be a substitute for the Proposed Accounting Standards Update or any other potential or applicable accounting literature or SEC regulations. Companies applying GAAP or filing with the SEC should apply the texts of the relevant laws, regulations, and accounting requirements, consider their particular circumstances, and consult their accounting and legal advisors.

**This is a publication of KPMG's
Department of Professional Practice
212-909-5600**

Contributing authors:

Robert G. Hilbert
David J. Reavy
Brian C. Stevens
Michael D. Martens

Earlier editions are available at:
www.us.kpmg.com/definingissues

Defining Issues® is a registered trademark of KPMG LLP.
©2001-2009 KPMG LLP, a U.S. limited liability partnership and a member firm of the network of independent member firms affiliated with KPMG International, a Swiss cooperative. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. 21147NNS