

The Effect of Fair Value Accounting on Goldman Sachs

Response to July 29, 2010 FCIC Request

1. Please describe in detail how fair value accounting affected your company during the financial crisis and any challenges that your company experienced in applying the accounting standards and principles concerning fair value accounting. Please provide any financial data and narrative descriptions that illustrate the role played by fair value accounting on your company. In addition, please describe any difficulties with interpreting Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, and identify any accounting terminology in the Financial Accounting Standards related to fair value accounting that you or your accountants believed in 2007 or 2008 needed further clarification.

Response

Fair value accounting was a critical factor in our ability to weather the financial crisis. The fact that we diligently marked our positions to prevailing market prices ensured that we were fully aware of the deteriorating value of positions in our portfolios and it allowed us to make judgments about the best way to manage our risk – for example, to bring risk down and get “closer to home” or to promptly demand collateral from counterparties. We were able to do this free of concerns about the financial statement consequences of our actions because the losses due to declining prices had already been recognized, i.e., if a financial asset is already marked at the price at which it would sell in the current market, a subsequent sale of that position in order to reduce risk has no impact on profit or loss under fair value accounting because the impact has already been recorded in earnings. This would not be the case if an accounting model other than fair value was used.

This latter point is crucial. Firms that do not follow a fair value accounting model often must evaluate the trade-off between optimal risk management decisions and the financial statement consequences of their actions. Those consequences usually are negative, for example, the recognition of previously unreported losses and incremental reductions in capital. This often leads to suboptimal risk management decisions, with deleterious effects on financial stability.

We have had no meaningful difficulties interpreting or applying FAS 157 and believe its terminology is clear.

2. Did fair value accounting create uncertainty and problems at your company, which led to delays, marking otherwise valuable assets to zero or near-zero, and/or mark downs that were ultimately marked up? Please explain and provide examples.

Response

Fair value accounting did not create any uncertainty, problems or delays in the preparation of our financial statements. While it is true that in complex or illiquid markets fair value accounting can be difficult to apply and it certainly requires significant diligence and effort, we believe it is the only accounting model that correctly reflects economic reality for financial instruments and the additional effort required by financial institutions is entirely appropriate.

By using fair value accounting, we value assets based on what a willing buyer would pay for them in prevailing market conditions, and we did this throughout the crisis.

We do not value assets based on our view of their fundamental or intrinsic value. If we did, we believe we would be ignoring economic reality and engaging in imprudent risk management. No financial institution can properly manage the risk of its positions if it does not know what they are worth.

3. Please describe how the guidance issued by the Securities and Exchange Commission ("SEC") Office of the Chief Accountant and the Staff of the Financial Accounting Standards Board ("FASB") on September 30, 2008 concerning fair value accounting, the guidance issued by the Staff of the FASB on October 10, 2008 [FSP FAS 157-3], and/or any other public guidance or interpretations from 2007 or 2008 affected your company and your accounting practices. Please describe how, if at all, the guidance may have affected your company and your practices if it had been issued earlier in time (e.g., prior to the financial crisis). In particular, please describe and compare your accounting practices after: 1) the original issuance of FAS 157, 2) the guidance issued on September 30, 2008, 3) the FSP FAS 157-3 issued on October 10, 2008, and 4) any other public guidance on fair value accounting you deemed relevant.

Response

The fair value accounting guidance issued by the SEC's Office of the Chief Accountant and the FASB Staff in September and October 2008, respectively, had no impact on Goldman Sachs because that guidance reinforced the fundamental and long standing principles of fair value which were already fully in place at our firm.

4. Please describe any efforts by your company or persons acting on your behalf to obtain guidance or interpretation from the SEC, FASB, Public Company Accounting Oversight Board ("PCAOB"), or any other public or private organization concerning fair value accounting in 2007 or 2008. Please provide copies of comment letters that you sent to the SEC, FASB, PCAOB, or any other public or private organization in 2007 or 2008 regarding fair value accounting or proposed changes to accounting rules.

Response

To the best of our knowledge, neither we nor any persons acting on our behalf sought to obtain guidance or interpretation from the SEC, the FASB, the PCAOB, or any other public or private organization in 2007 and 2008 on how to mark our positions, as the guidance in FAS 157 was quite clear and understandable.

Please see Exhibit One for a list of our comment letters with copies attached.

5. In your view, do you believe fair value accounting caused or contributed to the financial crisis? Please explain.

Response

Fair value accounting did not, in any way, either cause or contribute to the financial crisis.

The purpose of accounting is to provide information.

Because the information being provided by fair value accounting was not appropriately heeded when asset values were rapidly declining, too many firms were unprepared and did not take appropriate actions to mitigate the risks they were taking. Instead of using fair value, many followed an "available-for-sale" accounting model that allowed for delayed recognition of losses, even as markets began to deteriorate. The lack of fair value accounting contributed to a sense of denial – for example, that housing prices could not decline further – until it was

too late to take measures that could have ameliorated the negative impact of falling home prices.

Many large firms have stated that fair value accounting is difficult to apply, and it requires considerable resources to implement. Yet those same firms are active participants in the capital markets and would be expected to have a thorough understanding of prices and market dynamics. Therefore, they should be able to apply fair value accounting.

In addition, many firms devote considerable resources to implementing the different interest income, loss provisioning and asset impairment models that exist in a non fair value accounting world. If resources were redirected and focused on fair value accounting, financial institutions would have a better understanding of their risk exposures and the value of their positions, which would contribute to greater financial stability and their ability to better withstand the next financial crisis.

Exhibit One – Comment Letters sent by Goldman Sachs to the SEC, FASB, PCAOB or any other public or private organizations in 2007 and 2008 on fair value accounting or proposed changes to fair value accounting rules

1. April 12, 2007 letter to FASB on the Invitation to Comment, *Valuation Guidance for Financial Reporting*, stating additional valuation guidance was not needed out of concerns FAS 157 could become a set of rules and not principles; that FAS 157 is intentionally a principles-based standard that provides a sufficient framework to measure fair value appropriately.
2. May 4, 2007 comment letter to the International Accounting Standards Board (“IASB”) on their discussion paper, *Fair Value Measurements*, stating we believe that the guidance in FAS 157, having been through a lengthy process of consultation, represents the most up to date thinking and provides a superior framework for the application of fair value measurement.
3. September 19, 2008 comment letter to the IASB as part of their joint discussion paper with the FASB on *Reducing Complexity in Reporting Financial Instruments*, supporting fair value accounting as a way to reduce complexity.
4. October 3, 2008 comment letter to FASB on the proposed amendments to FAS 140 and FIN 46(R), suggesting an alternative approach to the accounting for transfers of financial assets and consolidation of variable interest entities, including greater use of fair value accounting.

TAB 1

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Matthew L. Schroeder
Managing Director
Accounting Policy



April 12, 2007

Mr. Lawrence W. Smith
Director, TA&I – FSP
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 1520-100

Re: Valuation Guidance for Financial Reporting

Dear Mr. Smith:

Goldman Sachs appreciates the opportunity to respond to the Board's Invitation to Comment ("ITC") on whether the Board should provide additional Valuation Guidance for Financial Reporting. We do not believe additional valuation guidance is needed and urge the Board not to add such a project to its agenda.

We believe the fair value measurement guidance provided by Statement 157 provides a sufficient framework to measure fair value appropriately. We agree with the observation in the ITC that Statement 157 does not address many detailed or specific valuation issues. In fact, during the deliberation of Statement 157, the Board acknowledged that valuation techniques will differ, depending on the asset or liability and the availability of data, and recommended that preparers use the technique that is appropriate in the circumstances and for which there are sufficient data. The Board consciously chose a principles-based approach, which we and many others supported. Having embarked on that path, we are concerned a valuation standards group could easily turn Statement 157 into a rules-based standard, similar to what happened with Statement 133.

If the Board elects to proceed down a different path, we believe the Board should first allow preparers, auditors and other interested parties sufficient time to adopt and gain experience with the application of Statement 157. After ample time has passed, the Board should analyze whether additional principles-based guidance is needed. Until that

happens, it will not be clear whether there is any diversity in practice or whether there are any pressing practice issues that result from the adoption of SFAS 157.

We also believe the Board should retain full authority over any valuation standard group that may be established in the future. As noted in Statement 154, accounting principles include the methods of applying those principles. Since the Board has full authority over accounting principles, it should have full authority over accounting methods.

Finally, we believe most financial institutions are adept at measuring the fair values of the financial instruments they hold. With the rapid pace at which new financial instruments are developed, we do not believe any form of detailed guidance would be able to keep pace with the rate at which financial instruments are developed. Accordingly, if the Board feels guidance is necessary for some fair value measurements, we request that financial instruments be excluded from the scope of the guidance.

Please contact me if we can be of further assistance or if you have questions about our comments.

Sincerely,



Matthew L. Schroeder

TAB 2

04 MAY 2007 17:59 FROM GOLDMANSACHS TO 0020720011 PAGE 10
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0020720011
PAGE 10

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CommentLetters@iasb.org

4 May 2007

**Re: Discussion paper: Fair value measurements
Part 1: Invitation to comment and relevant IFRS guidance, Part 2 SFAS 157 Fair
value measurements**

Dear Sir

Goldman Sachs appreciates the opportunity to comment on the above referenced Discussion Paper on Fair Value Measurements. The use of fair value is a critical accounting policy for us that we have used for decades. Our substantial experience in this area, particularly with regards to financial instruments, gives us a perspective that we trust the IASB will find helpful. Our comments in this letter pertain to fair value measurement as applied to financial instruments and should be viewed in this context.

Goldman Sachs continues to support the convergence between national and international standards and in particular have strongly supported the IASB and FASB on the convergence of their projects on fair value measurement in order to achieve consistency in application. In order to achieve comparability for investors, improve confidence in financial reporting and ultimately eliminate the need for reconciliations between GAAPs, equivalence in the measurement of fair value is paramount; a situation in which an identical instrument held at fair value by two institutions could have different fair value measurement methodologies is conceptually flawed.

With respect to financial instruments, we believe that the guidance in SFAS 157, having been through a lengthy process of consultation, represents the most up to date thinking and provides a superior framework for the application of fair value measurement.

We would encourage the Board to proceed with the issuance of an Exposure Draft based on SFAS 157 with minimal amendment. While we have a number of comments and suggestions for further development of the standard, in the interest of consistency, we believe that these should be the subject of joint discussion with the FASB as part of any potential improvements to the measurement standard.

We would welcome the opportunity to discuss any of our comments with the Board and its staff. Please contact Stephen Davies on 020 774 3804.

Yours sincerely

A handwritten signature in black ink that reads "Stephen Davies". The signature is written in a cursive style with a large, looped initial 'S'.

Stephen Davies
Managing Director

Appendix

Issue 1 SFAS 157 and fair value measurement guidance in current IFRSs

Question 1: In your view, would a single source of guidance for all fair value measurement in IFRS both reduce complexity and improve consistency in measuring fair value? Why or why not?

Yes. We support the objective of developing a statement that clarifies the fair value measurement objective throughout GAAP and agree that a single definition and source of guidance for all measurement under IFRS would reduce complexity and improve consistency. Much of the existing fair value measurement guidance within IFRS has been developed at different times and with different requirements in mind leading to inconsistent definitions of fair value and a lack of comparability in fair value measurement techniques. We believe that the proposed standard will help to reduce diversity in practice with regards to fair value measurement techniques and welcome the efforts of the IASB and FASB to converge their projects in this area.

Question 2: Is there fair value measurement guidance in IFRS that you believe is preferable to the provisions of SFAS 157? If so, please explain?

No. We believe that the overall framework for fair value measurement set out in SFAS 157 is preferable to the provisions of IFRS and supported the work of the FASB in developing guidance on methods used to determine fair values. SFAS 157 represents (for financial instruments) the most up to date thinking and has been developed through a process of extensive consultation. SFAS 157 sets out a largely principle based approach to fair value measurement that should provide a long term framework for fair value measurement of current and future instruments. Since the guidance contained within IFRS was developed over time and with differing objectives in mind it may be either out of date or inconsistent; SFAS 157 provides a fair value measurement standard that will lead to greater consistency across different markets and products.

Issue 2 Differences between the definitions of fair value in SFAS 157 and in IFRSs

Question 3: Do you agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owe the liability? Why or why not?

Yes. We agree with the exit price definition of fair value provided in SFAS 157. The use of exit price most appropriately reflects the risks and benefits that a reporting entity bears and is consistent with the Framework's definitions of an asset or liability which are defined respectively in terms of inflows or outflows of economic benefit. The use of exit price will enable consistent measurement to be applied throughout the lifetime of an asset or liability that will generally be based on market expectations rather than entity specific expectations. The incorporation in the definition as being from the 'perspective of a market participant' is consistent with the application of fair value measurement in practice and the risk management activities of entities within the financial community.

Even if an entity has no intention of disposing of an item, the exit price, where fair value measurement is applied, demonstrates the opportunity cost of continuing to hold the asset and is relevant information for financial statement users.

Question 4: Do you believe an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity? Why or why not? Additionally, do you agree with the view that, excluding transaction costs, entry and exit price will differ only when they occur in different markets? Please provide a basis for your views?

Generally no. An entry price is conceptually more akin to the current cost to acquire an asset (its replacement cost) and does not necessarily represent the inflows that an entity will achieve. For example in owning an asset there is an expectation of inflows rather than outflows and it is conceptually less appropriate to measure an asset on the basis of future outflows (that would be required to replace the asset). Even excluding the circumstances when they occur in different markets, there are other situations when entry and exit price may differ. There are a number of examples of these situations given in SFAS 157:17. Further situations when differences may arise include:

- where the purchase is of an equity interest that creates a controlling interest the combined interest can potentially be sold at a control premium;
- where purchase of an asset that completes a collection – the ‘in-use’ fair value of the collection may be greater than the entry price for individual items;
- in a purchase of financial instruments as part of a structured product to achieve a complex objective which may be transacted at an entry price that is different to the exit price of the individual instruments.

However, notwithstanding the bid-offer spread, entry and exit prices measured at the same time and in the same liquid market are likely to be similar in the majority of cases.

Question 5: Would it be advisable to eliminate the term “fair value” and replace it with terms, such as “current exit price” or “current entry price”, that more closely reflect the measurement objective for each situation? Please provide a basis for your views.

No. We would not support a proposal to replace with term ‘fair value’ with additional terms as we believe the addition for further terms will add to confusion. In the interest of consistency, we believe there should be a single definition of fair value with consistently applied terminology.

In the context of the question, we believe that the focus should be on whether fair value, consistent with the proposed definition, is the appropriate and intended measurement basis to be applied to the specific asset or liability in question. There are sufficient alternative measurement bases within GAAP that can be utilised without adding confusion to or diluting the meaning of fair value.

Question 6: Does the exit price measurement objective in SFAS 157 differ from fair value measurement in IFRS as applied in practice? If so, which fair value measurements in IFRSs differ from the measurement objective in SFAS 157? In those circumstances, is the measurement objective as applied in practice an entry price? If not, what is the measurement objective applied in practice? Please provide a basis for your views.

Generally no. For financial instruments the exit price measurement in SFAS 157 is likely to equate to fair value measurement as applied within IFRS with the exception of the following key differences:

- SFAS 157 permits fair value measurement at a price within the bid-offer spread that most accurately represents the exit price the entity would achieve in practice. In respect of financial assets traded in an active market, IAS 39 explicitly requires the use of the bid or offer price (as applicable);
- financial instruments whose fair value can only be measured using unobservable inputs would be measured at the transaction price as best estimate of fair value under IAS 39. SFAS 157 would permit the use of an exit price valuation that may differ to the transaction price.

Question 7: Do you agree with how the market participant view is articulated in SFAS 157? Why or why not?

Yes. We concur with articulated market participant view; this outlines the linkage between a market based measurement (rather than entity specific measurement) and the market participants. In addition, it allows the view that different markets with different participants (for example the retail versus the wholesale markets for financial instruments) may have different exit prices.

Question 8: Do you agree that the market participant view in SFAS 157 is consistent with the concepts of "knowledgeable, willing parties" and "arm's length transaction" as defined in IFRSs? If not, how do you believe they differ?

Yes. We believe that the market participant view in SFAS 157 is broadly consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' in IFRS.

Question 9: Do you agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant? Why or why not?

Yes. We agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant (with no difference in non-performance risk) as this should in principle lead to a valuation that would be consistent with the fair valuation of the asset by the counterparty.

Such a definition excludes the amount required to settle the liability that was incorporated in the fair value definition under IAS 39 but concur with the IASB comment in paragraph 23 that the term 'transfer' more accurately describes the fair value measurement objective in IFRS.

Question 10: Does the transfer measurement objective for liabilities in SFAS 157 differ from fair value measurements required by IFRSs as applied in practice? If so, in practice which fair value measurements under IFRSs differ from the transfer measurement objective in SFAS 157 and how do they differ?

Yes, in certain circumstances, we believe the transfer measurement objective in SFAS 157 does differ from IFRS as applied in practice. Under IFRS, fair value is defined as the amount for which a liability could be settled and does not restrict the fair value measurement to a transfer between market participants. As an example, the fair value for a demand deposit under IFRS is not less than the amount payable on demand discounted from the earliest date that payment could be required. This may differ to a transfer amount between market participants. As a further example, the specific guidance in IFRS for recognising liabilities at fair value in a business combination requires these liabilities to be measured at the present value of the amounts to be disbursed in settling the liability.

Issues 3: Transaction price and fair value at initial recognition

Question 11: In your view is it appropriate to use a measurement that includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price? Alternatively, in your view, in the absence of a fair value measurement based solely on observable market inputs, should the transaction price be presumed to be fair value at initial recognition, thereby potentially resulting in the deferral of day-one gains and losses? Please give reasons for your views.

Yes. We have strongly supported the view that a consistent valuation standard should be used through the life of an asset or liability and should not vary between initial and subsequent measurement. By utilising exit value as fair value there is a move away from the presumption that a transaction price, being the historic entry price, is always the best estimate of fair value. There are circumstances in practice where a transaction price is not the best estimate of fair value, most commonly where a transaction takes place in a market different to that in which the asset would be sold or the liability transferred, such as for securities dealers that transact in both the retail and inter-dealer markets. In addition, factors specific to the transaction, some examples of which are given in SFAS 157:17, may lead to a transaction price that is not equal to fair value. A better estimate of fair value and the future economic inflows or outflows may be obtained using other approaches; this may include entity specific attributes.

However, in accordance with the overall framework, all measures should be sufficiently reliable. Where model parameters or inputs are not observable because they rely on more significant entity inputs we believe there must be corroborating market evidence before revenue is recognised in order to satisfy the qualitative characteristics of the framework. In addition, sufficient disclosure should be given to enable a user of the accounts to understand the basis of the fair value estimations. There are comprehensive disclosures included in IFRS 7, extended by SFAS 157, to allow users of accounts to understand the methods used to determine fair values for financial instruments.

Question 12: Do you believe that the provisions of SFAS 157, considered in conjunction with the unit of account guidance in IAS 39, would result in a portfolio-based valuation of identifiable risks of instruments considered in aggregate, or an in-exchange exit price for the individual instruments? Please give reasons for your views.

SFAS 157 does not prescribe a unit of account for assets and liabilities measured at fair value with the exception of assets or liabilities quoted in active markets which are measured on an individual instrument basis. IAS 39 contains similar provisions with equivalent guidance for quoted financial instruments in AG72 but there is no explicit guidance for other assets and liabilities on the appropriate unit of account.

In addition, with respect to financial instruments quoted in active markets, IAS 39 permits valuing offsetting positions by applying the bid offer spread to the net open position. The IASB in the past has supported this treatment on the basis that cash flows are locked in and the matched position could be sold without incurring the bid/ask spread. In practice, this is consistent with how an institution will manage the risks in a portfolio, and an individual asset would not be risk managed in isolation. The rationale for the treatment of offsetting positions under IAS 39 can be extended beyond financial

instruments quoted in active markets as this more accurately reflects how an institution manages its risk.

Past discussion papers have highlighted that a portfolio of assets may have a different fair value to the individual components but have not confirmed which to use. The use of an exit value as the determinant of fair value in order to achieve the best indicator of future cash flows would support a portfolio approach consistent with the SFAS 157 'In-use' measurement criteria for asset and the current IAS 39 rationale for offsetting positions in quoted instruments. However, 'In-use' valuation is applied only to assets within SFAS 157 and is not specifically applicable to liabilities; many institutions manage portfolio risk (for examples on portfolios of derivatives) on portfolios that may include both assets and liabilities and we believe that the scope of 'In-use' premise should be clarified to more accurately reflect the business model and risk management activities of institutions.

Issue 4 Principal (or most advantageous market)

Question 13: Do you agree that a fair value measurement should be based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability? Why or why not?

Yes. We agree this is the appropriate approach as a fair value measurement based on the principal market is consistent with the exit price notion of fair value. The principal market is the market that an entity is most likely to transfer the item and therefore provides the best estimate of future cash flows; in most cases this is most likely to give an independent market with most active and informed market participants - in economic terms most likely to be the most efficient market. Prioritising the principal market over the most advantageous market provides a more practical solution to fair value measurement as it does not require an entity to investigate pricing and transaction costs in numerous markets in order to establish the fair value measurement.

In the absence of a principal market we agree that the use of the most advantageous market meets the criteria for deriving the exit value.

Issue 5 Attributes specific to the asset or liability

Question 14: Do you agree that a fair value measurement should consider attributes specific to the asset or liability that market participants would consider in pricing the asset or liability? If not, why?

Yes. We agree that fair value measurement should consider attributes specific to the asset or liability that market participants would consider; if such attributes were not considered at arriving in the fair value then the measurement would not equate to the exit price.

Question 15: Do you agree that transaction costs that would be incurred in a transaction to sell an asset or transfer a liability are an attribute of the transaction and not of the asset or liability?

If not, why?

Yes. We agree in general that transactions costs that would be incurred on a sale of an asset or transfer of a liability are not an attribute of the asset. However, there are situations in practice where transaction costs would be considered a specific attribute of the asset for example transportation costs – such costs to be incurred in delivering an asset to the pricing market relate to a specific attribute of the asset, namely its location.

Question 16: Do you agree that the risk of non-performance, including credit risk, should be considered in measuring the fair value of a liability? If not, why?

Yes. We believe that the consideration of the risk of non-performance, including an entity's own creditworthiness, in the fair value measurement of liabilities is consistent with the view to adjust for credit risk in determining fair value of assets. Such a treatment ensures consistency between the asset and liability side (i.e. the fair value of an entity holding the receivable should equate to the fair value of the liability to the borrower). This approach ensures that the credit risk component of a valuation methodology includes all risks related to the underlying contractual agreement. We believe that the market considers the effect of an entity's credit worthiness in the fair value measurement of derivative liabilities and that therefore the entity has the ability to realise this effect. Valuations incorporating ones own credit risk recognise that borrowing costs increase when credit worthiness decreases and vice versa and thus reflects changes in fair value in the period they occur as gains and losses and in future income statements through higher or lower effective interest. We believe that the SFAS 157 guidance confirms guidance currently existing within IAS 39 and the boards conclusions in IAS 39 BC 89.

There are often concerns raised that recording a gain as a result of a credit deterioration will provide confusing information to users of financial statements and that such a gain may not be realisable. While we are sympathetic to these concerns a measurement that does not incorporate non-performance risk would not be a fair value measurement and we thus support the proposed position within SFAS 157. In addition, the disclosure requirements of IFRS 7 provide sufficient information to allow a user to understand the impact of such changes in non-performance risk.

Notwithstanding the above, in incorporating credit risk into fair value measurement it will be necessary to consider if market participants actually take this into account in pricing the instrument. This can be expected to vary from market to market and depending on the underlying instrument and its tenor.

Issue 7 'In-use valuation premise' versus 'value in use'

Question 17: Is it clear that the 'in-use valuation premise' used to measure the fair value of an asset in SFAS 157 is different from 'value in use' in IAS 36? Why or why not?

Yes. We believe that it is clear that the 'in use' valuation premise is different from 'value in use' within IAS 36 for the reasons as set out in paragraph 45 of the discussion paper. 'In use' valuation remains a market participant measure based on the amount a market participant would pay for the asset assuming that the asset would be used with other assets readily available to the market participant. The definition of 'value in use' is an entity specific measure.

Issue 8 Fair value hierarchy

Question 18: Do you agree with the hierarchy in SFAS 157? If not, why?

We do not necessarily believe that a hierarchy of methodologies is required other than to prioritise the valuation methods and inputs. There is a risk that the classification of instruments into levels of the hierarchy promulgates the view that fair values derived from observable prices are superior to those determined using other valuation techniques. We do not believe that this is necessarily the case if fair value measurements are properly applied. In addition, the hierarchy introduces artificial bright lines that may introduce

practical issues. For example, exposures and their collateral are managed on a risk or counterparty basis not consistent with the hierarchical structure.

However, we support the principle of the approach in that it prioritises the inputs to be used to derive fair value measurements and in the event that a hierarchy is deemed necessary, we consider the hierarchy to be reasonable as it applies the concept of exit price consistently at all levels and does provide clarity as regards how a fair value measurement has been determined by an entity.

Question 19: Are the differences between the levels of the hierarchy clear? If not, what additional information would be helpful in clarifying the differences between the levels?

Yes. We believe that the conceptual distinctions between the levels of the hierarchy are generally clear with the hierarchy requiring an instrument to be disclosed in the lowest level of the hierarchy for which it has a significant input on the estimation of fair value. What constitutes a significant input is not defined and this will require the application of judgment in practice.

Issue 9: Large positions of a single financial instrument (blocks)

Question 20: Do you agree with the provision of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market (Level 1)? In addition, do you agree that this provision should apply as a principle to all levels of the hierarchy? Please provide a basis for your views.

No. We have always strongly supported allowing the use of a blockage discount at all levels of the hierarchy including active markets. We believe this reflects the way broker-dealers manage their business and is consistent with an exit value concept when disposing of a block of securities. Basing the value of a portfolio, where blockage factors exist, on the price of an individual instrument multiplied by the quantity does not appropriately reflect the fair value of the portfolio (see Q12 response) and this is the case whether the inputs are within Level 1 or not.

For example, if an institution purchases a block of securities at a discount to the market price for an individual instrument an immediate gain would be recognised on measurement at 'fair value'; this gain would most likely reverse as the position is traded out either as a block (at the discounted price) or in small quantities over a more extended period the act of which would likely depress the price achieved. We do not believe that such a measurement approach enables the accounts to reflect properly the economics of the transactions and the performance of the entity. We believe that it is more appropriate to be subjective in measuring the fair value of such a block position rather than requiring measurement at the quoted price in order to achieve objectivity. The calculation of fair value adjustments for blockage factors often requires a lesser degree of subjectivity than many other estimates that are required both by this standard and in other areas of GAAP.

For the reasons above we would not support any proposed extension on a prohibition on blockage factors to other levels of the hierarchy. Many broker dealers both purchase and sell securities in blocks. Where securities cannot be sold in individual trading units, the value of the position is affected by the size of the whole position to be sold. Hence, the determination of the instrument's value depends on the size of the position to be sold (i.e. the unit of account). As a result, we do not agree that the provision to prohibit blockage

adjustments should apply to all levels of the hierarchy before specifying the unit of account to be used for instruments which do not have quoted market prices. In addition, in non active markets there is more exposure to liquidity risk in the ability to disinvest a position and more likelihood in practice that other market participants are aware of the transactor/size of position and therefore will factor this into any pricing decisions. Consistent with Q12 we believe it is the value of the whole position that is key not its component parts. We believe that disclosure of any liquidity/block discounts could mitigate any risks and highlight inconsistencies in practice.

Issue 10 Measuring fair value within the bid-ask spread

Question 21: Do you agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157? Alternatively, do you believe that the guidance contained in IFRSs, which generally requires assets to be valued at the bid price and liabilities at the ask price, is more appropriate? Please explain the basis for your view.

Yes. We think that it is reasonable that an entity determine using its own judgment where within the spread the exit price will be. While in practice a dealer may quote a bid-offer spread, it is common to trade within this spread dependent on such factors as the entities overall risk exposure or the counterparty with whom they are trading.

In addition, where items managed as a portfolio are evaluated and measured on this basis, bid/offer adjustments should reflect the exit value of disposing of the portfolio as a whole rather than on an individual transaction basis as this more faithfully represents the way an entity manages its risk and prices its portfolio positions.

We would expect that in many cases this would lead to the same result as IAS 39 and a more accurate reflection of the exit value.

Question 22: Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed even when another price within the bid-ask spread might be more representative of fair value? Why or why not?

We are not opposed to the guidance set out in paragraph 31 of SFAS 157. Use of a pricing convention as described may have benefits for a reporting entity in that it is more likely to be able to be applied systematically and hence more efficiently; however, this would come at the expense of potentially reducing the relevance of the reported fair value.

Question 23: Should bid-ask pricing guidance apply to all levels of the hierarchy, including when the fair value measurement includes unobservable inputs? Why or why not?

We believe that, to the extent that bid-ask spreads are available in non-active markets, they should be applied at all levels of the hierarchy. The SFAS 157 objective for fair value measurement is to measure an asset or liability at exit price and this definition applies to all levels of the hierarchy and should be applied consistently. However guidance may not be relevant at different levels as it is likely that bid/ask spreads are not readily available in non-active markets.

Issue 11 Disclosures

Question 24: Do the disclosure requirements of SFAS 157 provide sufficient information? If not, what additional disclosures do you believe would be helpful to users and why? Alternatively, are there disclosures required by SFAS 157 that you believe are excessive or not beneficial when considered in conjunction with other disclosures required by IFRSs? Please provide a basis for your view.

While we understand and support the objective of enhancing the disclosures relating to fair value measurement, the paragraph 32 disclosures concerning valuations within level 3 of the hierarchy make no distinction between fair value movements generated by movements in unobservable inputs and those caused by movements in observable inputs. The disclosure for level 3 as a whole may lead to misinterpretation of the level of exposure of an entity to gains and losses from instruments valued using unobservable data. For example, the gains and losses disclosed under paragraph 32(c)(1) may in practice be wholly driven by observable inputs with minimal gains and losses generated from the unobservable input(s) that necessitated the Level 3 classification. Further, it will be common for exposures classified within Level 3 to be wholly or partially hedged by exposures in Level 1 and Level 2 with corresponding partial offset of gains and losses; the presentation of the reconciliation for Level 3 in isolation in such circumstances may be misleading. If the disclosures are retained in their current form, we would encourage guidance on qualitative disclosure that would allow more appropriate interpretation of the reported information.

It is not clear at this stage how the disclosures required would interact with IFRS 7 and whether IFRS 7 disclosures would be supplemented or replaced by the proposed SFAS 157 disclosures.

Issue 12 Application guidance

Question 25: Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply under IFRSs? If not, please specify what additional guidance you believe is needed and why.

Yes. We believe that the guidance in Appendices A and B of SFAS 157 is sufficiently clear in illustrating the standard's principles and how they would be applied under IFRS.

The IASB has determined that where the new guidance creates conflict with existing measurement guidance for certain fair value items it will continue with the old guidance. However, it is not clear whether these items can or will be described as measured at fair value or whether they will be described as being held on another basis. Although we appreciate the pragmatic approach, the IASB needs to confirm whether these items are to be held at fair value and then ensure their measurement is consistent with the new guidance. If a measurement approach is permitted under the new guidance but is restricted (for example, only one of the valuation techniques can be used) then this should be articulated.

Question 26: Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply in emerging or developing markets? If not, please specify what additional guidance you believe is needed and the most effective way to provide this guidance (for example, through additional implementation guidance or through focused education efforts).

Yes. We believe that the guidance in Appendices A and B of SFAS 157 are clear in illustrating the standard's principles and thus could be applied within emerging or developing markets. SFAS 157 provides guidance for circumstances where a limited or no market exists for the instrument in question although the primary focus of the guidance is as pertains to situations in which an active market exists. While we believe that the situation is similar in IAS 39 (the concept of 'knowledgeable, willing parties' requires the construction of a similar hypothetical transaction) which has limited guidance, the development with the FASB of additional guidance would be beneficial.

Issue 13 Other matters

Question 27: Please provide comments on any other matters raised by the discussion paper.

The discussion paper does not address the fair value measurement of restricted securities. We encourage the IASB to provide guidance as to restrictions on the sale or use of a financial instrument effect the determination of its fair value with reference to the guidance in SEC ASR No. 113 "*Restricted Securities*".

The discussion paper did not deal with the IASB's views whether the transitional provisions as set out in SFAS 157 would be adopted into IFRS, nor the IASB's initial views on effective dates or early adoption.

TAB 3

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Matthew L. Schroeder
Managing Director
Global Head of Accounting Policy



September 19, 2008

By email to: www.iasb.org

Re: Discussion Paper: Reducing Complexity in Reporting Financial Instruments

Dear Sir / Madam,

Goldman Sachs appreciates the opportunity to comment on the International Accounting Standards Board's Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*. We support the IASB and FASB in their objective of improving financial reporting for financial instruments by developing standards that are more principles based and less complex. We strongly support the long term approach of measuring all financial instruments at fair value and our reasons supporting this approach are explained further in our responses below.

We believe that the current "mixed attribute" or "intent based" model raises many issues. This model does not provide the level of transparency and comparability that investors and shareholders need and introduces avoidable complexity into the preparation of financial statements. In our view, all financial instruments should be measured at fair value, regardless of the underlying business activity.

We appreciate that the objective of reporting all financial instruments at fair value through earnings may not be achievable in the short term. However, we believe that some of the current issues causing complexity can be mitigated. We support any intermediate approach to improve financial reporting, provided it does not detract from the long term goal.

* * * * *

We appreciate the opportunity to provide you with our views. If you have any questions regarding our comments, please contact me.

Sincerely,

A handwritten signature in cursive script that reads "Matthew L. Schroeder".

Matthew L. Schroeder

Appendix – Responses to specific questions raised by the IASB

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements?

If not, how should the IASB respond to assertions that the current requirements are too complex?

Goldman Sachs believes that current requirements require significant change to meet the concerns of preparers and the needs of users of financial statements.

The current intent based model does not provide users with information that is relevant, reliable, understandable, comprehensive and comparable. The intent based model also raises many issues from preparers' perspective. Preparers are concerned about the difficulties in applying and interpreting the current rules, the cost of complying and the risks of inadvertently breaching the rules.

Complexity exists in many facets of the financial reporting and part of it is unavoidable due to the increasingly sophisticated nature of business transactions and the judgment required in applying accounting policies to such complex products. The IASB and FASB can certainly reduce complexity through intermediate solutions aiming at improving the current mixed attribute model. However, we believe that an improved mixed attribute model will not necessarily increase the quality and usefulness of financial reporting and hence will not meet the concerns of preparers and the needs of users.

Reducing complexity is only part of the solution; the concerns of preparers and the needs of users will only be achieved when all financial instruments will be measured at fair value. Fair value accounting for all financial instruments accompanied with a robust disclosure regime and education initiatives are the significant changes required to meet the concerns of preparers and users.

Question 2

- (a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3*
- (b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?*

Goldman Sachs supports the long term approach of measuring all financial instruments at fair value and our reasons supporting this approach are explained further in our responses below.

We appreciate that this approach may not be achievable in the short term. We believe that some of the current issues causing complexity can be mitigated and would therefore support intermediate approaches to improve financial reporting, provided they did not detract from the long term goal. Intermediate approaches should be a building block towards the long-term solution. We would not support intermediate approaches that would further delay the application of the full fair value measurement approach.

For the reasons mentioned above, we agree with criteria set out in 2.2 and more specifically criterion (b) requiring that any proposed intermediate changes must be consistent with the long-term measurement objective. We believe that the overall objective of a project improving reporting financial instruments should be to enhance the relevance, reliability, comparability and understandability of the information provided and the full fair value measurement approach is the only one meeting this objective.

We encourage the IASB to work closely with the FASB in considering intermediate approaches in order to not duplicate work and increase efficiency. Amending either set of standards in a piece meal fashion on areas such as hedge accounting would not only complicate analysis by users but would also require constituents to transition twice, to carry out significant changes and incur implementation costs.

Question 3 (p.21)

Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

The Discussion Paper suggests two different approaches to amend the existing measurement requirements: 1) reducing the number of categories and 2) simplifying or eliminating some of the requirements or restrictions of the existing categories.

We believe the current approach of classifying financial instruments in to four different categories – where classification is based primarily on management intent – has no conceptual basis and does not meet the objective of providing users with reliable and comparable information. Management intent is subjective, change over time, is difficult to audit and undermines comparability. In addition, the many ways of measuring financial instruments and the associated rules create difficulties for preparers of financial statements and their auditors, for example, difficulties in distinguishing between types of financial instruments ('classification'), difficulties in identifying and quantifying impairment, difficulties to apply the extensive set of hedge accounting rules. The different ways to measure financial instruments may result in two identical instruments being measured differently by the same entity or two identical instruments being measured differently by different entities.

A possible approach suggested in the Discussion Paper is the elimination of the held-to-maturity and available-for-sale categories. We would support the elimination of these categories as we believe they create an artificial distinction between instruments for different entities. One instrument could be considered trading or available-for-sale or held-to-maturity by different entities, resulting in completely different reported earnings; we would therefore support any steps to reduce this discrepancy.

Another possible approach suggested in the Discussion Paper is to simplify or eliminate some of the requirements or restrictions of the existing categories. We believe that such an approach would probably reduce complexity for preparers (less risk of breaching rules, less variation in rules) but at a cost to the user. The absence of tainting rules or clear hurdle would create an undesirable cherry picking environment that would not result in comparable and useful information. Furthermore, reducing the rules or relaxing criteria may not necessarily increase the use of fair value as entities would/may take advantage of easier qualifications for categories such as held to maturity to avoid marking to market where current guidance would not allow this option. As a result we would not support any approaches aiming at eliminating or relaxing the current restrictions of the existing categories.

Fair value is the most appropriate model to measure all financial instruments and accordingly we believe that existing measurement categories should be reduced to a minimum and clear hurdles should limit the use of any remaining "other than fair value" categories.

Question 4 (p.23)

Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

- (a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?*
- (b) How should instruments that are not measured at fair value be measured?*
- (c) When should impairment losses be recognised and how should the amount of impairment losses be measured?*
- (d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?*
- (e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?*

A fair value measurement principle with some optional exceptions is, in theory, an acceptable interim solution. This approach has some conceptual merit, is consistent with the both Board's long-term objectives and would represent an improvement in reporting financial instruments.

However, we have concerns about the details of the proposal and in particular the criteria for identifying the exceptions. Consequently, we believe it could be very difficult to apply in practice. The unavoidable introduction of some guidance (e.g. additional rules, bright lines, etc) would not result in more easily understandable (and comparable) information and would not reduce complexity for preparers and auditors.

In respect of the specific questions outlined above:

a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value?

We do not believe that financial instruments should be measured at something other than fair value through earnings. If the Boards believe it is an acceptable trade-off to deviate from that approach, then it should be allowed only in very specific and limited circumstances and for cost-benefit reasons, for example, financial instruments held by a SME that has limited valuation infrastructure, financial instruments for which it can be reasonably demonstrated that cost approximates fair value. We believe that this choice should be part of an entity's accounting policy and should be done by class of assets and liabilities and not on a transaction by transaction basis.

Entities should disclose why they believe the alternative model provides more useful information. Entity specific objectives, management intent or simplicity arguments are not in our view acceptable reasons to justify the use of an alternative model.

The accounting policy should be applied consistently. A change in accounting policy should be allowed only if it results in a more appropriate presentation. We believe it is unlikely that a change from the fair value model to another measurement model will result in a more appropriate presentation.

b) *How should instruments that are not measured at fair value be measured?*

They should be measured at the lower of cost or fair value.

c) *When should impairment losses be recognised and how should the amount of impairment losses be measured?*

We believe that the current impairment model is a source of complexity for preparers and does not provide users with comparable information. Current impairment models are inconsistent and therefore can be confusing when assessing for objective evidence of impairment and when impairment losses should be reversed. Consistent with our response to question a), we believe that the impairment losses model should be the same across different categories. Impairment should be recognised for a class of assets if its carrying amount exceeds its fair value and the amount of impairment should be calculated by reference to the fair value of that class of asset.

d) *Where should unrealised gains and losses be recognised on instruments measured at fair value?*

Unrealised gains and losses on instruments measured at fair value should be recognised in the same way as realised gains and losses that is, in earnings. The fact that they are not realised does not make them less relevant or reliable. They result from the same valuation and validation processes as realised gains and losses and are valuable key performance indicators. Recognising them outside earnings will result in less comparable information and will increase complexity for preparers.

e) *Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for?*

No

Question 5 (p.25)

Approach 3 sets out possible simplifications of hedge accounting.

(a) Should hedge accounting be eliminated? Why or why not?

(b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting

i) Which method(s) should the IASB consider, and why

(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure your comments are consistent with your suggested approach to changing measurement requirements

a) Hedge accounting is an essential part of any mixed attribute model and accordingly hedge accounting should continue to be permitted as long as a mixed measurement model exists. Even if full fair value was to be endorsed for financial instruments, the need would not be removed as hedge accounting is used for non-financial positions and /or unrecognised positions (e.g. firm commitments). Given that the scope of an eventual fair value measurement requirement is one area that still needs to be addressed by both Boards (and given the impact that any scope inclusions/exclusions may have) we find it difficult to comment on the elimination of the fair value hedge accounting at this stage.

b)(i) The Discussion Paper sets out three possible approaches to replacing fair value hedge accounting 1) substitute a fair value option for instruments that would otherwise be hedged items 2) permit recognition outside earnings of gains and losses on financial instruments designated as hedging instruments and 3) permit recognition outside earnings of gains and losses on financial instruments.

Adding broad flexibility (as contemplated by approaches 1 and 3) would not improve comparability between entities and defeat the purpose of making a change. While we acknowledge that approach 2 may receive some support amongst constituents, we believe that the reduction in complexity is unlikely to be significant and this has the added disadvantages of being confusing for many users, of not reducing complexity currently associated with cash flow hedge accounting (e.g. reclassification to earnings of gains and losses initially recognised in other comprehensive income) and of having no basis in accounting concepts. For all these reasons we believe that the IASB should not consider any of these alternatives.

b)(ii) One of the main arguments against fair value is in regard to the inclusion of credit risk in the fair value measurement of a financial liability that is not a derivative (we exclude derivatives because dealers periodically realize credit valuation adjustments through unwinds and other settlements of derivatives). Opponents to fair value argue that requiring an entity to consider the effect of changes in the credit risk of a financial liability is confusing and produces counter-intuitive results. We generally do not support this view but are aware that this area of accounting has been highly controversial recently. Given the amount of concerns raised we believe that the IASB and FASB should consider a method having the following features:

- All financial instruments are measured at fair value
- Gains and losses are recognised in earnings
- For financial liabilities that are not derivatives, entities would have the option to recognise or not recognise in earnings the effect of changes in their credit risk.

We believe that this method – with its more limited flexibility than approaches 1 and 3 – provides more relevant and understandable information for users and would result in more financial instruments being measured at fair value.

Question 6

Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.

- (a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?*
- (b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?*
- (c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity*
- (d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?*

We believe that the Board's intent to simplify hedge accounting is a worthwhile project but we do not agree with the possible ways set out in the Discussion Paper.

In our view, certain of the proposed amendments to FAS 133 in the United States provide a good reference point to simplify the hedging requirements of IAS 39. Specifically, we would support the US proposal to replace the notion of a highly effective hedging relationship and allow hedge accounting for 'reasonably offsetting' relationships. In addition, the proposals would allow a qualitative prospective assessment of hedge effectiveness in most circumstances at inception and prospectively with ineffectiveness measured on a quantitative basis with all ineffectiveness going to profit and loss.

Goldman Sachs would not support the proposed restrictions on the application of partial hedges. Whilst the hedging of individual risks associated with a financial instrument can be complex, it is important to continue to allow this approach as this will result in more relevant financial information for the user. In order that a business can report the way it economically hedges its risk, it also be important that organisations continue to be able to hedge portions of specific cash flows. In addition we would not support the proposal to restrict an entity's ability to de-designate and re-designate hedging relationships. The ability to start or discontinue with hedge accounting at any point in time is an important principle within the requirements of hedge accounting and removing this ability would have a significant effect on current practice and would unnecessarily complicate hedge accounting practice.

Question 7

Do you have any other intermediate approaches for the IASB to consider other than those set out in Section 2? If so, what are they and why should the IASB consider them?

We believe there are a number of other areas the IASB could consider to reduce complexity in reporting financial instruments

One of these areas is investments where the reporting entity has significant influence. The equity method of accounting adds to the complexity and variety of measurement methods for financial assets. Complexity arises from determining whether an investor has significant influence over an investee and from accessing the necessary information to be able to apply the equity method of accounting. We would therefore encourage the IASB to converge with the FASB and to provide the ability to fair value these instruments.

The reporting related to involvements with off balance sheet special purpose entities is another area where complexity can be reduced. The recent financial market turmoil has highlighted the need for clarity about the treatment of off-balance sheet entities and about the risks they pose to financial institutions. We believe all involvements with an off-balance sheet special purpose entity – to which the reporting entity transferred assets or sponsored – should be accounted for at fair value. Such an approach would provide an important back stop to the consolidation analysis of special purpose entities.

The IASB and FASB could consider the development and implementation of a plan to strengthen the infrastructure to support and encourage use of fair value. Specifically, educational seminars to better inform users about the characteristics of the fair value reporting. We believe that much opposition to fair value has stemmed from misconception and misunderstanding.

Question 8

To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

We do believe that using a single method to measure all types of financial instruments is appropriate. The use of a single method would reduce confusion related to measurement mismatches, would simplify reported information and make it easier for users to understand and compare the results of different entities.

The current "intent based" model attempts to combine elements of historical cost accounting with elements of fair value accounting, by allowing management to choose which method to use based on its intended actions for each financial instrument. An entity can have three identical financial assets and intend to hold one to maturity and, therefore, account for it at historical cost, hold another as 'available for sale', with any changes in fair value bypassing the income statement and being applied directly to the firm's equity, and have yet a third marked at fair value, with increases or decreases being reflected in the income statement because of an intent to trade the instrument in the near term. We believe similar financial instruments should be accounted for in similar manner, regardless of the underlying business activity or whether the entity has the intent to sell it or not.

A business activity or intent based model raises many issues. Even if one puts aside the difficulty of basing an entire accounting regime on the intent of management, which must surely change regularly as circumstances change, this approach fails to provide the level of transparency that investors and shareholders would seem to need. Under this approach, the current net worth of an enterprise is largely opaque to the reader of the financial statements. Comparability between entities is also lost, as the same instrument could be held by different entities at cost or fair value, or both, depending on the particular intent of management.

The objective of financial reporting is to provide information about the financial position, performance and changes in the financial position of an enterprise that is useful to a wide range of users in making economic decisions. As long as entities use different method to measure financial instruments, this objective cannot be achieved. Users need a benchmark, a comparable measure, in order to make rationale economic decisions.

When more than one measurement attribute is used, guidance is required for each one. A single method of measure would mitigate the need for detailed application guidance and would prevent entities to 'cherry pick' or structure transaction to achieve a desired measurement attribute and artificial best result for financial reporting.

For all these reasons, one single measure would make financial information more valuable from the perspective of users.

Question 9

Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.

- (a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?*
- (b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments*

We believe that fair value is the only measurement attribute model for all types of financial instruments and fully support the IASB and FASB long term objective. Not only do we support the use of fair value measurement for all financial instruments but also for all other assets and liabilities held for trading purposes (e.g. commodities) which we believe should be included within the scope of a standard for financial instruments.

The main argument for fair value accounting is that it reflects current economic reality more accurately than the more conventional accounting model, which generally records and maintains financial assets and liabilities at some variance of historical cost.

Management assumes a responsibility to capital providers to manage resources in a way which protects the business from unfavourable economic factors. Under the current mixed attribute model, the method of accounting chosen can impede management's ability to make the right economic decision at any given point in time (e.g. the decision to not sell a held-to-maturity investment because it would 'taint' the rest of the portfolio). The current mixed attribute model fails to provide the level of transparency that investors and shareholders need to assess the stewardship or accountability of management. Comparability between entities is also lost.

In contrast, fair value reflects the current cash equivalent of the entity's financial instruments rather than the price of a past transaction. It is a neutral and transparent measure, free from management bias and unaffected by what was originally paid for the investment. A fair value model also generally leads to the more timely recognition of losses as the economic gain or loss are recognised as occurred.

Fair value has more predictive value than historical cost for those items held with the aim to earn the return through managing them on a fair value basis. Fair value is the best reflection of the expected future cash flows. It also predicts the ability of the entity to take advantage of opportunities or to react to adverse situations. For those items that the entity has no intention of disposing of, fair value demonstrates the opportunity cost of continuing to hold the asset and is relevant information for financial statement users.

The fair value model may not be a perfect accounting regime, but accounting perfection is an illusive goal. What is needed is the best method of measuring and managing the current financial health and risks of an organisation—a method that is understandable, relevant, comparable and as transparent as possible. Fair value accounting, together with a robust disclosure regime, comes closest to achieving this goal.

Question 10

Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

The Discussion Paper properly addresses the most common source of concerns about fair value measurement and we do not think that there are any other significant concerns that need to be addressed.

Some have expressed concerns about a mandatory use of fair value for all financial instruments. In large part, those concerns focus on the reliability and the volatility associated to fair value. We believe these concerns have been overly magnified by preparers having demanded, over the last years, exceptions from the use of fair value in financial reporting, resisted its use, and/or entered into transactions that they otherwise would not have undertaken to artificially limit earnings volatility.

In cases involving very illiquid instruments, fair value might be perceived by some constituents as being less reliable than cost because of the necessary use of appropriate management judgment in determining fair value. We believe that is a spurious argument as the impairment analysis required under a cost model equally relies on the appropriate use of management judgment and estimates and assumptions resulting in complex calculations.

While we recognise that there are difficult issues associated with the application of fair value accounting, particularly with respect to instruments for which there is little or no direct price transparency, we believe that prices for most financial assets and liabilities can be obtained through monitoring even highly reduced activity levels, obtaining broker quotes, using pricing services, monitoring collateral movements or extrapolating from similar instruments, etc.

The advantages of recording financial instruments at fair value significantly outweigh the potential difficulties. The use of a full fair value measurement model would significantly reduce the need for exception based accounting such as fair value hedge accounting and impairment requirements and will better align financial reporting with risk management. Fair value measurement for all financial instruments would eliminate artificial volatility caused by measuring financial instruments differently. Businesses most likely use some estimate of fair value to enter into transactions and hence to report this fair value should not necessarily add complexity or reduce the reliability of the financial information.

We believe that concerns about the reliability and the volatility associated to fair value may be lessened in the future to the extent firms and regulators strengthen their risk management policies and related infrastructures. The application of globally consistent guidelines and enhanced disclosure requirements will bolster user's confidence in the reliability of fair value measurements and hopefully, will mitigate subjectivity concerns.

We do believe that a full fair value measurement model accompanied by enhanced disclosures will make it easier for users to understand and compare results of different entities.

Question 11

Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

- (a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?*
- (b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?*

As mentioned earlier, we believe that fair value is the only measurement attribute model for all types of financial instruments and fully support the IASB and FASB long term objective. Although we recognise the current mixed attribute system of historic cost and fair value is likely to continue in the short term, we believe that issues identified by the Discussion Paper (presentation, disclosure, measurement and scope) do not represent real impediments to the fair value measurement as a general requirement for all types of financial instruments.

The measurement issue is currently under review and has been deliberated a few times by the Board. We are confident that a standard will be published in 2010 as currently planned and that convergence will be achieved.

Projects about disclosure and presentation can run parallel to a full fair value measurement requirement project. They are not mutually exclusive. Enhanced disclosure will bolster users' confidence in the reliability of fair value measurements and as such is key to the success of a full fair value measurement model. Goldman Sachs would support presentation or disclosure projects aiming at a greater acceptance, a better understanding and further expansions of fair value measurements.

Question 12

Do you have any other comments for the IASB on how it could improve and simplify the accounting for financial instruments?

The measurement of all financial instruments at fair value would still result in the identification and separation of embedded derivatives from non-financial items and would not eliminate the need for fair value hedge accounting for commitments to buy/sell non-financial items.

Furthermore a lot of the current complexity in financial reporting relates to nonfinancial instruments held for trading purposes and managed at fair value by a broad array of market participants, for example, physical commodities and intangible assets such as emission allowances, storage and transportation contracts. These instruments can suffer the earnings mismatch of the mixed attribute model because they often are entered into in combination with other instruments accounted for at fair value as part of a trading strategy. Hedge accounting is generally unavailable because its requirements are difficult to meet and burdensome to apply. In short, we believe these instruments are prime candidates for fair value measurement and we strongly encourage both Boards to consider their inclusion in the scope of a revised standard.

TAB 4

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October 30, 2008

Mr. Russell G. Golden
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LETTER OF COMMENT NO. **3**

Re: Proposed Amendments to Statement 140 and FIN 46(R)

Dear Mr. Golden:

Goldman Sachs appreciates the opportunity to comment on the exposure drafts that would amend Statement 140, *Accounting for Transfers of Financial Assets*, and FIN 46(R), *Consolidation of Variable Interest Entities*. Our comments are as follows:

- The FASB and IASB have each undertaken separate derecognition and consolidation projects in response to the global credit crisis. FASB's project started first and the SEC understandably is pressing for rapid completion. As a result, both Boards are expected to issue separate standards, and then eventually converge, potentially requiring constituents to change their accounting twice – an inefficient use of time and resources. Ideally, both Boards should combine their separate projects, take the best of both, and issue a single set of identical standards as quickly as possible. We urge the FASB to reconsider the timing of its projects and engage the SEC in a similar dialogue. FASB's expected FSP, *Disclosures about Transfers of Financial Assets and Interests in Variable Interest Entities*, provides an appropriate bridge until then.
- The QSPE model is broken and we agree it should be eliminated.
- We support determining the primary beneficiary (parent) of a variable interest entity (VIE) on the basis of control so as to obtain benefits, a view we have long held and advocated. The Board's definition of control – power when it matters –

is very broad and will materially increase the balance sheets and reported leverage ratios of enterprises that service securitization and structured finance vehicles and have economic exposure to them. We are not convinced this is an appropriate outcome in the many situations where assets are held in a bankruptcy-remote entity, there is no practical ability to control, the liabilities have no explicit or implicit substantive recourse to the general credit of the parent enterprise, and the enterprise does not have exposure to a majority of the entity's substantive risks and rewards.

The Board appears comfortable with this outcome, perhaps believing higher reported leverage ratios are an effective means of informing users about an enterprise's risk exposures to these vehicles. We believe leverage is an imprecise indicator of risk that has the potential to both inform and mislead investors because it only informs how an instrument is financed and not its underlying risk profile.

- We believe the Board should consider alternative approaches. We prefer a holistic approach with three critical elements:
 1. **Practical ability to control** – we would define control as the practical ability to direct the substantive operating, investing, and/or financing activities of a VIE so as to obtain benefits. If an analysis of the VIE's governing documents and contractual arrangements reveals the enterprise does not have the practical ability to control, then the enterprise would not consolidate the VIE, unless it met the risks and rewards backstop.
 2. **Majority risks and rewards backstop** – we would require an enterprise to consolidate a VIE if it has majority exposure to the VIE's substantive risks or rewards (or both) as of the date it becomes involved with the VIE. We would not impose a particular risks and rewards framework, for example, expected losses. Rather, we would leave the choice of framework to preparers and their auditors exercising sound judgment based on a consideration of all relevant facts and circumstances, including explicit and implicit arrangements.
 3. **Greater use of fair value accounting** – we would require fair value accounting (with changes in fair value recognized in earnings) for all financial interests held by an enterprise in an unconsolidated VIE it sponsored or to which it transferred assets.
- We also would support a linked-presentation model as suggested by the joint comment letter of the American Securitization Forum and the Securities Industry and Financial Markets Association, if the Board retains its current model.
- Regardless of the ultimate consolidation model, we believe the Board should require fair value accounting for all financial interests held by an enterprise in an unconsolidated VIE it sponsored or to which it transferred assets. While the amendments to Statement 140 and FIN 46(R) will increase transparency, more can and should be done, given the scope and severity of the global credit crisis. Investors are demanding greater transparency. Fair value accounting, although

not perfect, provides better information to investors than alternative accounting treatments.

- We support requiring the enterprise to conduct ongoing assessments of an entity's status as a VIE and whether the enterprise is the primary beneficiary, if there are changes in control indicators, consistent with the report of The Counterparty Risk Management Policy Group III, *Containing Systemic Risk: The Road to Reform* (recommendation II-3). We do not believe ex-post changes in market conditions, per se, should trigger consolidation.
- We believe the second step in the Board's consolidation model should be deleted because expected losses, as a framework for measuring risks and rewards, has been discredited; we share the concerns expressed in paragraphs B17 through B19 of the FIN 46(R) exposure draft.
- We disagree with Board's decision to ignore the presence of kick-out rights in a VIE unless they are held by a single party. Kick-out rights can be substantive depending on the facts and circumstances. The Board is sending its constituents mixed messages; they are encouraged to use sound judgment in the qualitative primary beneficiary analysis, but are precluded from doing so when it comes to analyzing kick-out rights. We encourage the Board to resolve this inconsistency in favor of a principles-based approach that relies on the exercise of sound judgment in all circumstances.
- Our comments on the disclosure package are reflected in our comment letter about the disclosure FSP mentioned above.

Thank you for the opportunity to provide our views. As previously communicated, Goldman Sachs would like to participate in the Roundtable scheduled for November 6. If you have any questions or comments regarding our letter, please do not hesitate to contact me.

Sincerely,



Matthew L. Schroeder