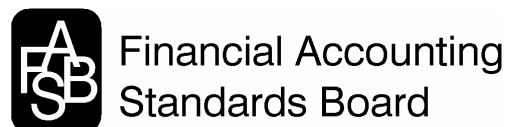


## MINUTES



**To:** Board Members

**From:** Fair Value Measurement Team  
(Hoermann, Ext 317)

**Subject:** Minutes of the September 21, 2004 FVM Public Roundtable      **Date:** October 4, 2004

**cc:** Bielstein, Smith, Petrone, Leisenring, Project Team, Mahoney, Thompson, Getz, Sutay, Gabriele, Swift, Polley, FASB Intranet

Topic: Proposed FASB Statement, *Fair Value Measurements*

Basis for Discussion: Agenda (attached)

Length of Discussion: 1:00 p.m. to 4:00 p.m.

Attendance:

Board members present: Seidman, Herz, Trott, Schipper, Batavick, Crooch, and Schieneman

Board members absent: None

Staff in charge of topic: MacDonald

Other staff at Board table: Munro, Pinson, Smith, Bielstein and Hoermann

Outside participants: Participant Listing (attached)

## **Summary of Decisions Reached:**

The Board held a public roundtable discussion with constituents to discuss issues relating to the proposed Statement, *Fair Value Measurements*. Board members and participants expressed their views; no decisions were reached.

## **Objective of the Roundtable**

The objective of this roundtable was to provide information to assist the Board in its redeliberations of the proposed Statement. That objective was met.

## **Matters Discussed**

*The following text summarizes participant responses to questions posed by Board members and topics discussed at the public roundtable; however, this summary does not include direct quotes from the meeting. The questions may not be in the specific order in which they were discussed at the meeting.*

## **FAIR VALUE DEFINITION**

### **The “Exchange” Notion for Assets and Liabilities**

Ms. Seidman asked Mr. Beier to comment on the exchange notion for assets and liabilities. He said that the “exchange” notion would not be applicable for liabilities because they are generally assumed or settled. He suggested that the definition be revised accordingly.

### **Valuation of Liabilities**

Mr. Young said that at Citigroup, they struggle with the idea of valuing all liabilities using an entity’s own credit spread. On one hand, they are not sure that it is ever realizable or that it is even relevant to creditors. On the other hand, they take credit into consideration in assets and believe that for purposes of symmetry it also should be reflected in liabilities. Ms. Masters agreed and added that it is not always practicable to mark to credit spread; it would introduce sensitivity to their own credit spread. Further, it is difficult to hedge that risk. Mr. Trott asked if at initial measurement Citibank would ever disregard credit spread when recording the liability. Mr. Young responded that at initial measurement he would consider the effect of credit spread but that the issue was the effect of changes in credit when remeasuring liabilities. Ms. Masters agreed.

### **Valuation Premise**

Ms. Glass commented that the ED is not clear on when an “in-use” versus an “in-exchange” valuation premise should be used. She suggested clarification through additional examples, especially for real property. Mr. Munter said that in selecting between the two premises, management’s intent is relevant. By way of example, he said that when the decision is to sell piece-meal, one should use an in-

exchange premise and when the intent is to keep an asset with synergies, one should use an in-use premise.

Ms. Schipper posed a hypothetical question about how to value land that the entity is planning to keep because of an existing plant located on the land, even though the entity could sell the land at a substantially higher price. Ms. Glass said that, in general, the land should be valued with the intent to keep operating the plant on that land. Depending on the specific facts and circumstances, the highest and best use may be to keep the plant rather than sell based on the economic costs that the entity would incur by selling the plant and having to relocate, etc. Mr. Schieneman said that he agreed that the plant should be valued based on the entity's intent and referred to instances (in Japan) where land is valued at amounts that are never realized.

Mr. Mard said that as an appraiser, he would like to have the scope given to him in order to be able to value something. He said that there is a need for further clarification of the premise in order to provide this scope. Ms. Glass said that she believes an appraiser has responsibility to determine that information.

## **FAIR VALUE HIERARCHY**

### **Objective**

Some participants indicated that the levels within the hierarchy might be overly restrictive. Ms. Ballenger said that companies should be allowed to use judgment when considering the trade-off between relevance and reliability when deciding on the appropriate valuation method to use, referring to situations in which thousands of fair value estimates might be required in a reporting period. She said that quoted prices might be available but that there are sometimes operational constraints in obtaining those prices and that in those situations, the hierarchy should allow the use of models, such as matrix pricing. Mr. Osterheld agreed, further pointing out that reliable source quotes are not always representative of fair value. He said that in those situations, one should be allowed to use models if it results in a better estimate of fair value. Mr. Barker agreed that there are several instances where one gets better, more consistent prices with models than by just relying on quoted prices. He also said that large institutions have the ability to manipulate trading prices, in which case a quoted price might not represent fair value.

Mr. Munter said that the hierarchy is a useful construct for organizing and framing reliability. He suggested more guidance around quoted prices focusing on situations in which a price is stale or when the market is "thin." Ms. Masters disagreed, stating that the hierarchy should not be prescriptive, especially given its application broadly to both financial and nonfinancial assets and liabilities.

Mr. Trott said that the Board decided not to provide prescriptive guidance on stale prices and thin markets to allow flexibility, which is what he thought most constituents wanted. He said that comments on the need for more definitions appears contradictory.

## **Level 1**

Mr. Osterheld said that the Board should address the issue of reliability in this initial phase of the project since he believes there are several instances when a Level 1 price quote is not representative of fair value. He also disagreed with the notion of “most advantageous markets,” noting possible inconsistencies with principal trading markets and the related SEC guidance for identifying those markets.

## **Bid/Ask Spread Pricing**

Mr. Young said that the proposed guidance for offsetting positions (mid-market pricing) should be applied on a portfolio basis within and across all levels of the hierarchy, since that is how most companies manage their risk. Mr. Baker suggested the use of mid-market pricing across the board.

## **Level 3**

Mr. King advocated changes to conform the proposed guidance for using valuation approaches and techniques to existing valuation practices, noting that the ED could be interpreted to mandate a market approach over a cost approach in certain circumstances, and all approaches for other items without regard to whether all approaches are applicable. Ms. Ballenger agreed, stating that an entity should not be required to use all three valuation approaches for all Level 3 estimates. Ms. MacDonald clarified that it was not the intent of the Board to require application of a valuation approach (or technique) that is not applicable.

## **DISCLOSURES**

Many participants indicated support for the proposed summary disclosures about the techniques used to measure various assets and liabilities (for example, Mr. Young referred to the precision of the measurement). Many of those participants objected to the proposed income statement disclosures (unrealized gains or losses). They said that distinguishing between realized and unrealized gains and losses creates a stigma for unrealized gains or losses. Moreover, those disclosures would require significant additional costs because it is not current practice to separately track those amounts and would not provide meaningful information (to users or management). Mr. Laux emphasized concerns about adding new fair value disclosures piece-meal, stating that the Board should develop a disclosure framework for all of the fair value disclosures required in GAAP.

## **OTHER ISSUES**

### **EITF Issue 02-3**

Many participants expressed concerns over the perceived inconsistency between EITF Issue No. 02-3, “Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk

Management Activities,” and the ED. Mr. Young and others said that the conflict should be resolved in the scope of a final Statement.

### **Blockage Factors**

Mr. Osterheld stated that he vigorously opposes block discounts. He said that block discounts are contrary to fair value. Further, his institution (Fidelity) has analysis which demonstrates that in the past, they were considered to hold a large position representing a “block” but that they were able to get out of the position without recognizing a price effect (that is, at “P”). Ms. Seidman noted that the business activity described by Mr. Osterheld is different from what she would describe as “block trading.”

### **Interaction with Other FASB Projects**

Mr. Mard said that the ED (Appendix A) continues to indicate a preference for the risk-adjusted cash flow method, which is a concern because that method continues to be difficult to apply. He explained that general valuation practice is to rely on risk-adjusted discount rates. Ms. Schipper clarified that the ED does not require a risk-adjusted cash flow model; it only highlights it. Mr. Munter suggested that the Board amend FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, to reflect the revisions made to the related guidance carried forward in Appendix A.

Mr. Dilorio said that convergence with the IASB is very important for fair value measurements.

Mr. Laux emphasized concerns about the tradeoffs between relevance and reliability of fair value measurements. He said that the ED does not necessarily improve the reliability of the measurements. That issue should be addressed at the concepts level. Moreover, addressing that issue should be a Board priority.

### **Implementation Guidance**

Participant views on the need for more implementation guidance varied. However, many participants, including Mr. King, agreed that if more implementation guidance is provided, it should address valuation of intangible assets, but generally, thereby allowing for judgment.

### **Follow-up Items:**

Mr. Trott asked Mr. Young and Ms. Masters to provide the Board with additional information on how they define and disclose measurement precision. They both agreed to do that.

### **General Announcements:**

None.

**FVM Roundtable Participants**  
**September 21, 2004**  
**1:00 p.m.-4:00 p.m.**

| <b><u>Name</u></b>         | <b><u>Organization</u></b>       | <b><u>CL #</u></b> |
|----------------------------|----------------------------------|--------------------|
| Al King                    | King Valuation Services, LLP     | 005                |
| Paul Munter                | KPMG                             | 007                |
| Blythe Masters             | JPMorganChase                    | 017                |
| Tim Barker                 | Totem Valuations                 | 031                |
| Carla Glass                | Appraisal Standards Board        | 034                |
| Mike Mard                  | Financial Consulting Group, L.C. | 042                |
| Anthony Dilorio            | Deutsche Bank                    | 048                |
| Melissa Ballenger          | Freddie Mac                      | 049                |
| Steve Young                | Citigroup                        | 051                |
| Ray Beier                  | PWC                              | 058                |
| Bob Laux                   | Microsoft                        | 062                |
| George Yungmann            | NAREIT                           | 075                |
| Mark Osterheld             | Fidelity                         | 082                |
| Jenifer Minke-Gerard       | SEC                              |                    |
| * Gregory Fletcher         | PCAOB                            |                    |
| Galina Ryltsova (by phone) | IASB                             |                    |

\* Scheduled but unable to participate

**AGENDA**  
**FAIR VALUE ROUNDTABLE**  
**September 21, 2004**

**INTRODUCTION (5 minutes)**

**FAIR VALUE DEFINITION (30 minutes)**

- The “exchange” notion (for assets and liabilities)
- Valuation of liabilities under current GAAP (using an entity’s own credit standing)
- Valuation premise (in-use versus in-exchange, interaction with highest and best use concept for assets)

**FAIR VALUE HIERARCHY (60 minutes)**

- Objective (measurement versus disclosure)
- Revisions to levels (considering valuation approaches and/or inputs)
- Level 1 reference markets (most advantageous markets versus principal trading markets, liquidity, “transaction” costs, application within other levels)
- Level 1 bid/asked spread pricing (offsetting positions, application within other levels)
- ***Level 3 valuation approaches (clarifications, single versus multiple)***

**DISCLOSURES (15 minutes)**

- Unrealized gains/losses
- Other

**OTHER ISSUES (60 minutes)**

- EITF Issue 02-03
- Changes in valuation techniques (including under EITF Issue 02-03)
- Use of blockage factors (broker/dealers, investment companies, other entities)
- Interaction with other FASB projects (improvements to conceptual framework, fair value option)
- Implementation guidance (financial versus nonfinancial, valuations of intangible assets)

**EFFECTIVE DATE (10 minutes)**

- Timing and Transition