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Ms. Suzanne Bielstein  
Director—Major Projects and Technical Activities  
File Reference No. 1201-100  
Financial Accounting Standards Board  
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Dear Ms. Bielstein:

BDO Seidman, LLP is pleased to submit this comment letter on the Exposure Draft (ED), *Fair Value Measurements*. We have prepared this letter with the assistance of the valuation professionals at our affiliate, Trenwith Valuation, LLC.

We agree that it is desirable for the Board to provide uniform guidance on the definition and measurement of fair value. With the increase in the number of elements of financial statements that are measured at fair value, it is timely to reconcile all of the inconsistencies that have developed over time. In this letter we provide a number of suggestions that we believe will make the Standard clearer and more operational.

Before responding to the specific questions for respondents, we have two general observations:

- Although this Standard does not require any new fair value measurements, we have an overriding concern that the Board believes this Standard will provide robust measurement guidance, and that as a result the Board will continue down the path of requiring fair value measurements for items, particularly liabilities, for which it is extremely difficult to estimate fair values because no active market exists. By contrast, we believe that the Standard accurately reflects the highly subjective state of the art for estimating the fair value of items, particularly liabilities, for which no active market exists. We believe that requiring fair value measurements for such items generally makes financial statements less, rather than more, useful. We urge the Board to move cautiously in requiring additional fair value measurements in those areas, and hope that the Board will not conclude that this Standard significantly aids preparers and auditors in making such measurements.
- Fair value measurements raise significant auditing issues in addition to significant accounting issues. We hope that the FASB will coordinate any expansion of fair value measurements with the PCAOB and the AICPA, so that improved auditing

standards can become effective at the same time as expanded fair value measurements.

Our comments on the specific questions to respondents follow:

*Issue 1: This proposed Statement would define fair value as "the price at which an asset or liability could be exchanged in a current transaction between knowledgeable, unrelated willing parties" (paragraph 4). The objective of the measurement is to estimate the price for an asset or liability in the absence of an actual exchange transaction for that asset or liability. Will entities be able to consistently apply the fair value measurement objective using the guidance provided by this proposed Statement together with other applicable valuation standards and generally accepted valuation practices? If not, what additional guidance is needed?*

We agree with the proposed definition of fair value and believe that it is consistent with established definitions and current practice of valuation professionals. As noted in our comments throughout this letter, we believe that fair value measurements for items not traded in active markets are subjective, and that entities in similar circumstances may estimate widely varying fair values.

*Issue 2: This proposed Statement would clarify and incorporate the guidance in FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, for using present value techniques to estimate fair value (Appendix A). Is that guidance sufficient? If not, what additional guidance is needed?*

We believe that the explanations in Appendix A are inadequate for the Standard's primary audience--accountants. If this Standard is a vehicle for introducing the accounting community to valuation concepts, we believe that it should contain far more explanation and commentary. For example, the Board briefly introduces the concepts of systematic and nonsystematic risk in footnote 12 and the concept of certainty equivalents in paragraph A17, but the explanations are inadequate for an accountant, or anyone else, who is unfamiliar with the concepts. We also believe accountants will find paragraphs A21 and A22 confusing, because they assert, with no explanation, that the compensation demanded by marketplace participants for assuming risks related to liabilities will typically be reflected as an increase in expected cash flows in some cases and as a decrease in expected cash flows in others.

We believe that most valuation practitioners appropriately favor the Discount Rate Adjustment (DRA) technique over the Expected Present Value (EPV) technique. Overall, there is greater certainty, and less variance, among valuation professionals in estimating discount rates, which are a central aspect of the DRA technique, than there is in creating, and then estimating probability weightings for, multiple cash flow projections, which are central to the EPV technique. In recent years there has been significant progress in estimating important aspects of an equity discount rate related to



unsystematic or company specific risk. Ibbotson Associates, a well-recognized investment consultancy, now publishes and regularly updates long-term historical information that quantifies adjustments to discount rates based on a Company's size, among other factors. Factors related to size generally capture a significant amount of the variability in expected returns among companies. As such, discount rates are more easily quantified and can be more objectively evaluated. By contrast, multiple cash flow projections and the probabilities assigned to them are subjective, and different valuation specialists (or managements) could develop widely varying assumptions, which may drastically affect estimated fair values. As such, the certainty among valuation professionals regarding the cost of capital has increased over time, whereas the certainty regarding cash flows, and the assignment of probability-weighted outcomes, remains at low levels.

We believe that Appendix A as drafted does not accurately portray the DRA technique as it is applied by valuation professionals. If multiple cash flow projections exist, we believe that the DRA technique is identical to the EPV technique, Method 2. Given three scenarios as in the example in paragraph A16, we believe that a valuation professional applying the DRA technique would discount the expected cash flows of \$780, not the base case, or most likely, cash flows of \$800. Therefore, we believe that the Appendix as drafted creates confusion.

Finally, we are confused by the discussion in paragraph A17.a. regarding how to explicitly adjust expected cash flows for risk.

*Issue 3: This proposed Statement would clarify that valuation techniques used to estimate fair value should emphasize market inputs, including those derived from active markets. In this proposed Statement, active markets are those in which quoted prices are readily and regularly available; readily available means that pricing information is currently accessible and regularly available means that transactions occur with sufficient frequency to provide pricing information on an ongoing basis. Is that guidance sufficient? If not, what additional guidance is needed?*

We agree that the guidance about using market inputs is adequate. However, we believe that the Board should explicitly acknowledge in the Standard that for many items, particularly liabilities, active markets don't exist.

*Issue 4: This proposed Statement would provide general guidance for selecting the valuation premise that should be used for estimates of fair value. Appendix B illustrates the application of that guidance (Example 3). Is that guidance sufficient? If not, what additional guidance is needed?*

We believe that the guidance for selecting the valuation premise is sufficient.

*Issue 5: This proposed Statement would establish a hierarchy for selecting the inputs that should be used in valuation techniques used to estimate fair value. Those inputs differ depending on whether assets and liabilities are identical, similar, or otherwise comparable. Appendix B provides general guidance for making those assessments (Example 4). Is that guidance sufficient? If not, what additional guidance is needed?*

We believe that Level 2 in the hierarchy, as the Board has defined it, is a null set. We are not aware of any asset or liability for which the price effect of differences is “objectively determinable.” It is axiomatic that a quoted market price (Level 1) is preferred in nearly all cases. If a quoted market price is not available, then the three approaches to value should be considered. A market approach by definition utilizes adjusted prices of assets or liabilities that are similar to the subject asset or liability. The adjustments made to the prices of similar assets (liabilities) are, without exception, based on analyst judgment as opposed to being “objectively determinable.” Nearly any quantification of adjustments to asset prices is masking subjectivity with numbers. Further, it is not clear how the Level 3 market approach is different from Level 2. Without a clearer distinction, the Standard will appear to favor the market approach even in cases where such favoritism is counter to standard valuation procedures.

*Issue 6: In this proposed Statement, the Level 1 reference market is the active market to which an entity has immediate access or, if the entity has immediate access to multiple active markets, the most advantageous market. Appendix B provides general guidance for selecting the appropriate reference market (Example 5). Is that guidance sufficient? If not, what additional guidance is needed?*

We believe the guidance on selecting the appropriate reference market is appropriate.

*Issue 7: This proposed Statement would require that the fair value of financial instruments traded in active dealer markets where bid and asked prices are more readily and regularly available than closing prices be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities), except as otherwise specified for offsetting positions. Do you agree? If not, what alternative approaches should the Board consider?*

We agree with the proposed application of bid and asked prices. However, it strikes us as paradoxical that the Board is providing specific measurement guidance for the relatively narrow spreads in active dealer markets while providing little guidance to narrow the relatively wide spreads that exist in estimated fair values for items not traded in active markets.

*Issue 8: For unrestricted securities with quoted prices in active markets, many FASB pronouncements (including FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments) require that fair value be estimated as the product of a quoted price for an individual trading unit times the quantity held. In all cases, the unit of*

*account is the individual trading unit. For large positions of such securities (blocks) held by broker-dealers and certain investment companies, the AICPA Audit and Accounting Guides for those industries (the Guides) permit fair value to be estimated using blockage factors (adjustments to quoted prices) in limited circumstances. In those cases, the unit of account is a block. The Board initially decided to address that inconsistency in this proposed Statement as it relates to broker-dealers and investment companies. The Board agreed that the threshold issue is one of determining the appropriate unit of account. However, the Board disagreed on whether the appropriate unit of account is the individual trading unit (requiring the use of quoted prices) or a block (permitting the use of blockage factors). The majority of the Board believes that the appropriate unit of account is a block. However, the Board was unable to define that unit or otherwise establish a threshold criterion for determining when a block exists as a basis for using a blockage factor. The Board subsequently decided that for measurement of blocks held by broker-dealers and certain investment companies, current practice as permitted under the Guides should remain unchanged until such time as the Board fully considers those issues. For those measurements, do you agree with the Board's decision? If applicable, what approaches should the Board consider for defining a block? What, if any, additional guidance is needed for measuring a block?*

We agree with the Board majority that the appropriate unit of account is a block. We also agree that neither a uniform definition of blockage nor an objective measurement of blockage factors exists. In those circumstances, we believe the best course of action would be to (1) state the principle that the appropriate unit of account is a block and (2) include an appendix that communicates the results of the research done by the AICPA Blockage Factor Task Force. As measurement techniques improve over time, the Board could revisit the issue and provide further guidance based on best practices.

Therefore, we agree with the proposal to retain the provisions in the AICPA Guides for broker-dealers and investment companies. We would prefer that the Board permit the use of blockage factors generally, consistent with the principle that the appropriate unit of account is a block, rather than limiting their use to two industries.

For many years, the proponents of fair value have asked the question, "would you rather be approximately right or precisely wrong?" On this issue, we believe that the use of blockage factors is "approximately right" and that the multiplication of the number of shares in a large block times the quoted price of a single share is "precisely wrong."

Whatever the Board decides on this issue should be included in the body of the Standard. In the Exposure Draft, we could not find the guidance in the body of the Standard; it seems to be presented only in the basis for conclusions.

*Issue 9: This proposed Statement would require that in the absence of quoted prices for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach,*

*and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort (Level 3 estimates). Appendix B provides general guidance for applying multiple valuation techniques (Examples 6-8). Is that guidance sufficient? If not, what additional guidance is needed?*

Consistent with professional valuation standards, the valuation of an asset or liability must consider using multiple valuation techniques – i.e., the market, income, and cost approaches. However, which of these approaches should be employed in a specific case often depends on the type of asset or liability being valued and the quality and availability of overall information. As an example, for the valuation of many intangible assets the income approach is often the optimal approach, whereas the cost and market approaches have limited, if any, application.

Overall, it is our belief that the Standard should indicate that an essential aspect of valuing an asset or liability involves the identification of those methods that should be applied. Further, when use of multiple techniques is appropriate, the valuation should clearly state the rationale behind whatever weighting is incorporated, even if the weightings are equal.

We believe that the guidance in Appendix B generally is appropriate, although we believe in certain cases it casts unnecessary aspersions on the income and cost approaches. Further, we believe that a greater number of examples would be helpful in clarifying the variety and different types of analysis that an accountant may encounter. Multi-period excess earnings for the valuation and lifing of customer lists and a relief from royalty method for the valuation of a patent are but two suggested examples.

*Issue 10: This proposed Statement would require that the fair value of restricted securities be estimated using the quoted price of an otherwise identical unrestricted security, adjusted for the effect of the restriction. Appendix B provides general guidance for developing those estimates, which incorporates the relevant guidance in SEC ASR No. 113, Statement Regarding "Restricted Securities." Is that guidance sufficient? If not, what additional guidance is needed?*

We agree with the approach for valuing restricted securities. The guidance in Appendix B is scanty, but we are not aware of any additional extant guidance. Like blockage factors, valuation of restricted securities involves subjective factors.

*Issue 11: This proposed Statement would require expanded disclosures about the use of fair value to remeasure assets and liabilities recognized in the statement of financial position. Appendix B illustrates those disclosures. This proposed Statement also would encourage disclosures about other similar remeasurements that, like fair value, represent current amounts. The Board concluded that those disclosures would improve the quality of information provided to users of financial statements. Do you agree? If not, why not?*



We believe that the objectives of the proposed disclosures are appropriate but that the actual disclosure requirements exceed what is necessary to accomplish the objectives.

For assets and liabilities that are remeasured at fair value on a recurring basis, we believe that readers should know the following information, to assess the objectivity/subjectivity of fair value estimates:

- The total end-of-period fair value of assets and of liabilities remeasured on a recurring basis, divided between those that are measured based on quoted prices in an active market and those that are measured in another way.
- The net change in fair value for the period, divided into the four categories—assets and liabilities that are measured based on quoted prices in an active market and assets and liabilities that are measured in another way.

We don't think it is useful to explain the extent to which market inputs were used for assets and liabilities not measured based on quoted prices in active markets, because (1) for multiple assets and liabilities the disclosure is likely to be at a high level of generality and (2) we don't understand how that information would affect readers' decisions.

For assets and liabilities that are remeasured at fair value on a nonrecurring basis, we believe that the Board should require only disclosure of whether the estimated fair values were measured based on quoted prices in an active market or in another way. We would delete the other proposed disclosures for the following reasons:

- The reason for the remeasurement and the amount of gain or loss recorded are substantially redundant to existing requirements for specific assets and liabilities.
- We do not understand how readers would use the disclosure about the fair value amounts. For example, if an enterprise has \$10 million of goodwill, of which \$2 million is carried at current fair value because of impairment, we do not understand what decisions the \$2 million amount will help the reader make.
- We don't think it is useful to explain the extent to which market inputs were used for assets and liabilities not measured based on quoted prices in active markets, for the same reasons stated above.

*Issue 12: This proposed Statement would be effective for financial statements issued for fiscal years beginning after June 15, 2005, and interim periods within those fiscal years. The Board believes that the effective date provides sufficient time for entities to make the changes necessary to implement this proposed Statement. Do you agree? If not, please explain the types of changes that would be required and indicate the additional time that would be needed to make those changes.*

Given that the Standard does not significantly change the procedures currently used to make fair value measurements, we believe the suggested effective date is reasonable.

*Issue 13: This proposed Statement represents the completion of the initial phase of this project. In subsequent phases, the Board expects to address other issues, including issues relating to the relevance and reliability of fair value measurements and the unit of*



*account that should be used for those measurements. What, if any, other issues should the Board address? How should the Board prioritize those issues?*

As stated in the introduction to this letter, we encourage the Board to address the relevance and reliability of fair value measurements for items, particularly liabilities, for which an active market does not exist, before requiring additional fair value measurements. We believe that such highly subjective estimates diminish the usefulness of financial statements and believe the Board should obtain evidence to the contrary before requiring additional fair value measurements. We believe that it also would be desirable to develop better guidance on unit of account (blockage) and restriction issues before requiring additional fair value measurements. As noted in the introduction to this letter, we also recommend that the Board coordinate any expansion of fair value measurements with auditing standards setters.

We would be pleased to discuss our comments with the Board or the FASB staff. Please direct questions to Ben Neuhausen at 312-616-4661.

Very truly yours,

s/ BDO Seidman, LLP