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FSPFAS157D

LETTER OF COMMENT NO. 38

October 8, 2008

Russell G. Golden, FASB Technical Director
by e-mail: director@fasb.org

Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

File Reference: Proposed FSP FAS 157-d

Dear Mr. Golden:

We appreciate the opportunity to comment on the proposal by the FASB Staff to amend FASB Statement No.157, *Fair Value Measurements,* that is represented by the exposure draft (ED), FSP FAS 157-d, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active.* We wish to use the opportunity also to share our views on broader issues about the now highly controversial subject of fair value accounting that go beyond the scope of the ED as presently proposed. For your information, the two authors of this comment letter have been audit professionals for a total in excess of 70 years, and one is also a licensed general real estate appraiser with many years of valuation training and experience.

We fully understand and concur with the prevalent views currently advocated by the FASB, the AICPA's Center for Audit Quality and others that fair value information can be both useful and relevant to investors and other financial statements users. However, we are concerned that when presented as a substitute for and to the exclusion of the more objectively determinable historical cost values that have been the traditional mainstay of financial reporting, the reliability of the financial statements taken as a whole will become significantly more difficult to assess and, in fact, impaired.

We believe that:

1. Fair value measures, although useful to readers of financial statements, are even more readily misunderstood by users than historical cost values and principles with which they are almost exclusively inconsistent. Therefore, in our opinion, fair value information generally should be presented as information that supplements (as opposed to substitutes for) historical cost information. This is obviously a complex, comprehensive subject, and it is not within the narrowly focused topics of the discussion draft, but rather, it is part of the core issue that we believe needs to be addressed.

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2. Most accounting and auditing professionals lack, and the accounting profession in general, lacks sufficient valuation experience and training to establish, administer, regulate, and integrate "fair value" reporting in an economically meaningful way that is easy to understand by the readers of financial statements into what may remain, in many cases, a primarily historical cost-based reporting model. It seems to us that financial reporting should be either value-based or cost-based with few overlaps, none of which should be characterized as "fair value" as the general public might misinterpret that term, or a valuation expert might define it for specific circumstances. An appraisal / valuation professional typically has years of valuation training, often in specific areas, and related experience comparable to, but different from, the training and experience historically expected of and associated with accounting and auditing professionals. Again, this comment is not directly within the narrow focus of the discussion draft topics, but it is also part of the core issue that we believe needs to be addressed.

3. Accounting standards regarding the applicability of what are termed "fair value" measures appear arbitrary to the valuation professional and generally use a "paint-by-numbers" approach to guide those that lack basic competency in such matters. For example, in a purely value-based reporting model, there would be no justifiable economic reason why an investment in a debt instrument expected to be held to maturity should be reported on some basis different from its so-called "fair value" at the report date. Similarly, no justification would be (or is, for that matter) for different accounting for securities held to maturity *vs.* held for trading or for sale as to valuation adjustments such as unrealized gains and losses.

4. Paragraph 11a of the ED indicates that "the conclusions reached in the example are based on assumed facts and circumstances presented. Other approaches to determining fair value may be appropriate." Clearly, this is a true statement; however, neither the ED or any other related standards give meaningful guidance on possible alternative approaches (see item 5) or assumptions, and accounting and auditing professionals generally lack the necessary valuation training and expertise to identify and properly apply other approaches or assumptions. The reality is that the example presented will be another "paint-by-numbers" approach in most cases, and other approaches or assumptions will be open to second guessing and serious criticism by regulators and others. By the way, we nevertheless believe the example in the draft to be good information, and we are aware of a number of companies that have independently developed and use the same or a similar approach.

5. As reiterated in the ED, "a fair value measurement represents the price at which a transaction would occur between market participants at the measurement date." This definition presumes market participants when, in fact, the purpose of the ED is to provide guidance for when there is none. Also, the "at the measurement date" concept is inconsistent with the notion that the investment holding objective of a financial asset should make a difference as to how the asset is valued and accounted for and as to the value to be reported (*e.g.*, held to maturity *vs.* held for trading). We think this is a basic disconnect between "fair value" as used in our hybrid reporting model that the accounting standards have created *vs.* what valuation specialists and other critics would generally refer to as "economic value." For example, while only 6% of all mortgage-related loans are in default today (including 25% of all sub-prime loans from low credit rated borrowers), mortgage-backed securities are selling as low as 78% below their original issue price. While the "fair value" at the measurement date, as defined by the ED, might be 22% of the original issue price, as suggested in the illustrative facts, the value of the underlying collateral

might be 80% of the original issue price. This disparity cannot be tolerated if "accounting estimates" are to have creditability with financial statement users.

6. Maybe a "mass appraisal" technique applied to the underlying collateral would produce a better indication of value for financial accounting purposes of the mortgage securities with the result probably somewhere on the scale of values that might be reported under the three holding objectives currently articulated in SFAS 115, but we would not characterize the result as "fair value." We believe that if the accounting standards do not produce results that make economic sense within the reporting model used (and we believe this is frequently the case for all the reasons cited above), the standards need to be changed in a meaningful way. We point out that the narrow focus of the ED, as now written, does not in our opinion, accomplish this objective.

7. Maybe financial assets that are either not traded in an active market or traded only in "less active" markets should be accounted for on a cost recovery basis subject to periodic "impairment" considerations rather than subject to so-called "fair value" adjustments. This concept would be compatible with or similar to the "undiscounted cash flow" impairment test provided under SFAS 144 in connection with long-lived (another non-current group of) assets. Financial assets held for trading, however, would need to be valued under a different standard that would necessarily place more weight on the infrequent and distressed sales in the market place, which would likely produce, effectively, a liquidation value.

8. For decades, the accounting profession resisted the significant use of any "fair value" notion in historical financial statements because of its lack of objectivity and sufficiently reliable supporting evidence. Today, we are approaching a situation where almost all significant amounts in any entity's balance sheet are to be subjective estimates of value. Although SFAS 157 has put some transparency in and fences around the development of such estimates, they remain highly subjective and likely to present wide variability among issuers, valuation specialists and auditors in the same or similar circumstances. Notwithstanding substantial evidence of serious misunderstandings by financial statement users of the meaning of the term, "presents fairly," as used in audit opinions, such misunderstandings are likely to increase exponentially when the same, unmodified audit opinions are applied to so-called "fair value" statements as are now used with objective, historical cost-based financial statements. From an auditor's perspective, it would be far more acceptable if such "fair value" estimates were presented supplementally to the more reliable historical financial statements thus enabling independent auditors to express an "in relation to" opinion or a lower level of assurance thereon.

9. We, the accounting profession through our standard setters, do not seem to be responding to recent criticism objectively, rather we merely reaffirm the belief that we are right and everyone else is wrong and, therefore it must be our responsibility to convert those that criticize. Others would likely view such an approach as naïve and ignoring practical considerations, economic reality and the fundamental differences between true value-based and historical cost-based models of financial reporting that we pointed out above. Further, it is easily argued that the profession, for the most part, lacks the core competence to make fair value judgments. In our opinion, the "fair value" track that the profession is now on worldwide may literally destroy the profession as we know it and, at the least, certainly will not make it more respected but rather a bigger target for blame and legal liability.

We hope the FASB staff and the Board find our views useful in their deliberations on these important matters.

Very truly yours,
PIERCY BOWLER TAYLOR & KERN

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Managing Shareholder

Howard B. Levy, Sr. Principal and
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cc: James Kroeker, Deputy Chief Accountant for Accounting,
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Lillian Ceynowa, Director of Professional Practice & Member Relations
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