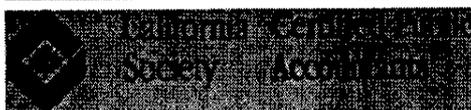


Sent: Thursday, October 07, 2004 8:05 PM
To: Director - FASB
Cc: 'Art Korn'
Subject: Fair Value Measurements File Reference #1201-100

Letter of Comment No: 89
File Reference: 1201-100
Date Received: 10-8-04

A comment letter from the California Society of CPAs follows:



October 7, 2004

Technical Director
Financial Accounting Standards Board

Sent by email to: director@fasb.org

RE: Proposed statement of Financial Accounting Standards, *Fair Value Measurements*
File Reference #1201-100

The Accounting Principles and Auditing Standards Committee of the California Society of Certified Public Accountants (the Committee) has discussed the proposed statement referenced above and is pleased to provide our comments.

The Committee is the senior technical committee of our state society. The Committee is comprised of 45 members, of whom 9% are from national CPA firms, 58% are from local or regional firms, 22 percent are sole practitioners, 7% are in industry and 4% are in academia.

We support the Board's efforts to gain consistency in the application of fair value measurements. However, we have several reservations in the guidance provided by the proposed statement. We are herein providing our comments for the Board's consideration.

General Comment

Before addressing the specific issues identified in the Notice for Recipients, we would like to provide an overall observation regarding the overall presentation of the proposed statement.

Except for those instances when the subject holds a small percentage of the outstanding units of financial instruments which are traded in an active market (such as on an exchange), measurement of fair value is inherently an estimation process. In lieu of the hierarchal rules-based approach presented, we recommend an approach where fair value is estimated based on facts and circumstances. Under this approach, all relevant information affecting the estimate of fair value would have to be considered in arriving at a conclusion. The standard should describe the three valuation techniques (i.e. cost, income and market) and provide guidance as to when and how the various techniques are to be applied. Comprehensive examples should be provided to help in the application of the standards.

Issue 1: Definition of Fair value

The Committee believes the proposed definition is an improvement over the current definition. Whether the standards are consistently applied will depend upon other factors, including the additional guidance included in the proposed statement.

Issue 2: Incorporation of FASB Concepts Statement No. 7

The Committee recommends that, if the Board believes that the Statement of Financial Accounting Concepts No. 7 needs clarification, the Board should amend SFAC No. 7 rather than attempt to make corrections by way of an Appendix to a Statement of Financial Accounting Standards.

The Committee has observed that the discussion in both SFAC No. 7 and Appendix A to the proposed statement emphasizes the "Expected Present Value Technique." This method is rarely used by valuation professionals in valuation engagements because of the inherent difficulty in assigning probabilities to various cash flow scenarios. In actual applications, this information generally cannot be objectively determined. Accordingly, we recommend that the discussion of this approach be reduced or even eliminated from the appendix to the proposed standard.

Issue 5: Hierarchy of Inputs

The Committee does not understand the need for a hierarchy. First, we are unclear what was intended to be included within Level 2 of the hierarchy. The proposed statement indicates that similar means "identical" except for some attributes, and "the price effect of the difference is objectively determinable." When the Committee applied a strict definition of objectively determinable, we were unable to identify any item which would fall within Level 2 because in every case, some subjective measure was required to estimate fair value. Appendix B does not clarify the intended differences between Level 2 and Level 3.

It seems there are only two categories: (1) items for which quoted prices exist and (2) items for which a quoted price does not exist. Even when quoted prices exist, the fair value of the items held may differ from quoted prices due to differences in quantities. For example, if the subject held a majority of the outstanding shares of stock in an entity, the value per share could be greater because the market might be willing to pay a premium for a controlling interest. On the other hand, if the subject held a large number of shares, but not a majority, of thinly-traded shares of stock, these holdings might have a lower value per share due to blockage factors.

Issue 7: Pricing in Dealer Markets

For pricing financial instruments traded in dealer markets, the Committee did not identify any theoretical basis to value stock sold short in a different manner than stock owned (long position). It seems that, after consideration of the reported buy and ask prices on a dealer market together with any other factors which should be considered, the subject might just as correctly conclude that the midpoint of bid and ask prices is the best estimate of fair value.

Issue 8: Blocks of Securities

The definition of fair value in the proposed statement reads in part "the price at which an asset or liability could be exchanged in a current transaction." If an entity holds a block of stock and if in a current exchange the block of stock would be expected to sell at a discount from the quoted

price for a single share, then it only makes sense that the estimate of fair value should recognize that discount. As stated earlier, we believe the determination of fair value should be on a facts and circumstances approach and blockage discounts should be a consideration for all industries, including those for which it is currently not permitted. Furthermore, the Board should not attempt to define when a block exists. We do not believe that this condition is subject to objective measures but will be dependent upon the facts and circumstances of each situation.

Issue 9: Level 3 Estimates

The Proposed statement requires that estimates of fair value be performed using multiple valuation techniques, unless cost considerations justify the exclusion on any of the techniques. We believe that the standards should simply indicate that estimates of fair value be determined based on an appropriate consideration of various valuation techniques as determined by the facts and circumstances. Cost constraints should be only one factor considered. For example, if a particular method of estimation provides convincing evidence of fair value, then calculations using other methods should not be required.

Issue 11: Disclosures

We believe that the disclosure table provided at B22 has far too many categories (columnar) for purposes of disclosing the method of estimating value. The table attempts a further refinement of the three levels of hierarchy by dividing Level 3 into two sublevels. As stated earlier, we believe that there are actually only two levels – quoted prices for identical items and estimates of value using models or other techniques. We believe any attempt to segregate items by those who valued with significant market inputs vs. significant entity inputs is too subjective and in many cases may not be possible. For example, if an estimate of value is calculated using two techniques — (1) stock prices of comparable companies and (2) discounted future cash flows — and each is given equal weight in the final estimate, should half the fair value be included in each of the columns headed “Significant Market Inputs” and “Significant Entity Inputs?”

We recommend that, for each account for which fair value has been reported, that there be a disclosure of fair values determined using quoted market prices and fair values estimated using other valuation techniques. Disclosure should also include a discussion of the valuation techniques utilized and include any other information that would be necessary for readers to understand the relative risks involved in the estimates.

* * * * *

We thank you for the opportunity to comment on the proposed statement. We would be pleased to discuss our observations with you further should you have any questions or require additional information.

Very truly yours,

David P. Tuttle, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants