

From: [Ron DiMattia](#)
To: [Director - FASB](#)
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Thank you for the opportunity to comment on the Proposed Accounting Standards Update issued August 28, 2009 titled Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements (file reference no. 1710-100). As noted in the Proposed Accounting Standards Update, "The Board believes that users will benefit from information about a *range of fair value* if the reporting entity were to use reasonably possible alternative inputs for Level 3 measurements and significant transfers between Levels 1, 2 and 3." I have included my comments in the following paragraphs.

A review of the FASB's efforts with SFAS 157 would be useful as a starting point. Since it was issued in September 2006, the standards set forth in SFAS 157 have been amended six (6) times, if I am not mistaken. In several of the amendments changes were proposed and adopted on very short notice.

In the current amendment, the greatest difficulty with the proposed changes is that the Board intends to continue the completely false assumption that Level 2 measurements are in some way more reliable than Level 3 measurements. And to back up that assumption, the Board is continuing with the requirement that Level 3 measurements have more detailed disclosures than Level 2 measurements. I have written the Board on this subject in the past, but it is worth reiterating because the FASB is working with a fundamentally flawed assumption that will only burden preparers with meaningless paper-work and will not provide useful information to financial statement users. In addition, it creates an incentive for preparers to use Level 2 measurements, and for auditors to view them as being more reliable. Wasn't this the reason that FSP FAS 157-d was written? In that amendment the FASB went to great lengths to explain that Level 2 measurements are not more reliable in those cases when markets are inactive (but that is not the only circumstance; the FASB did not fully analyze the issue). Yet in the current proposal, the FASB continues as if FSP FAS 157-d was never written stating, "because Level 3 measurements have a greater degree of uncertainty and subjectivity" (820-10-50-2A).

From a valuation perspective there is no functional difference in reliability between Level 2 and Level 3 measurements. Level 2 measurements encompass a wide range of calculations and introduce much subjectivity, which FSP FAS 157-d attempted to address, but only partially. Level 2 measurements are briefly defined as follows:

- a. Level 2 – Quoted price, similar asset, active market.
- b. Level 2 – Quoted price, identical or similar asset, inactive market.
- c. Level 2 – Inputs other than quoted prices that are observable.
- d. Level 2 – Inputs that are derived from or supported by observable market data.

Point (b), above, was already addressed in FSP FAS 157-d, although not adequately, and events of the last few years make it very clear that when markets are inactive Level 2 measurements can actually produce deeply flawed valuation results. Point (a) relates to the idea of similarity, which is a highly subjective assessment. For many valuation issues there will be a choice of "similar" assets and often the points of similarity will vary even among skilled analysts. The measurement is not as clearly defined as the FASB makes it out to be. Points (c) and (d) above cover a range of different inputs which would make it difficult to address in this letter, but they often encompass the idea of similarity and other subjective assessments that make their reliability suspect.

Interestingly, the theoretically correct method to measure value that is taught in every major university in the United States (discounted cash flow) would be considered a Level 3 measurement as defined by the FASB; and would be considered the least reliable of the available choices to measure value. It seems that the FASB is proposing that modern corporate finance theory is built on unreliable and subjective methods, and is offering a better way to do things.

It is clear that The FASB's proposals are not helpful to preparers or users of financial statements:

1. Effect of reasonably possible alternative Level 3 inputs – why should only Level 3 be subjected to such an analysis? Why shouldn't Level 2 also be subjected to sensitivity analyses? There are a range of choices within Level 2; there often is not just one similar asset. Also, the FASB states that "A reasonably possible change in inputs shall not include remote or worst case scenarios" (820-10-50-2 f). Is the FASB contradicting itself by saying this? Isn't the reason we are experiencing so much difficulty in financial reporting that we have experienced a remote and worst case scenario with some asset classes these last few years? Wasn't this the reason that FSP FAS 157-d was written? Didn't the remote and worst case scenario we are living through expose the deep flaws in SFAS 157? This requirement will get out of hand very quickly, and will create unnecessary tension between preparers of financial statements and their auditors and regulators. The ideas of "reasonably possible" and "remote" are very subjective and interpretations could vary wildly.
2. Transfers in and/or out of Levels 1 and 2 – Requiring financial statement preparers to state the reasons for transfers in and out of Levels 1 and 2 would seem to be problematic. I can envision instances in which disclosing reasons for the transfer would create a self-fulfilling prophecy. Importantly, transfers in and out of Levels 1 and 2 would seem to be caused principally by the level of activity in markets related to the asset being measured. Imagine a situation similar to that which spawned FSP FAS 157-d; markets become inactive enough to cause financial statement preparers to doubt the validity of the value measurements they derive from them. Presumably the preparer would have to state, "The market for this asset is too inactive to produce a reliable valuation result, so we are using a Level 3 measurement." Wouldn't that statement tend to freeze up markets more? If a large and respected participant in a market says the market is too inactive to be reliable, wouldn't that cause others to run for the exits? It is very true that markets are built upon confidence, and this requirement could actually undercut confidence in developing financial markets – which would negatively affect asset values, access to capital and innovation.
3. Activity in Level 3 fair value measurements - this continues the fallacy exposed in FSP FAS 157-d, but which the FASB is oddly resurrecting; that Level 2 measurements are somehow more reliable than Level 3 measurements.

I think after the fourth amendment to SFAS 157 I included a warning that further amendments would be needed because the ideas underlying SFAS 157 were simply not sustainable. I will repeat that warning here. Even after making the proposed changes cited above (and in many respects because of the changes being proposed), further amendments will be needed in the future because the ideas underlying SFAS 157 are not sustainable. Instead, the FASB should rescind SFAS 157 and completely re-consider its efforts regarding Fair Value accounting.

Thank you for your attention to my letter.

Sincerely,

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