

Appraisal Institute Response

FASB Fair Value Measurements

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Introduction

The following responses are specific only to portions of the captioned FASB Fair Value Measurements exposure draft (ED). We believe our response briefly illustrates why additional discussion is necessary with the Appraisal Institute, as well as others in the real property, personal property, and business valuation profession, prior to the establishment of “fair value measurement” standards. Because of the views expressed below, it is our opinion that such discussion will better flesh out differences and create improvements rather than for us to presume to write suggestions for an entire new proposed ED.

Although many of the principles found in the ED are in common with those of the valuation profession, and we recognize the broad spectrum of asset and liability issues addressed by the ED, it is our opinion that many of the suggested ED elements require revision to avoid significant and unnecessary market disruption. Thus, we have responded only in a representative fashion, and then incompletely, to support our request for additional opportunity to contribute to the eventual fair value measurement standards.

At the outset we emphasize that our comments should be understood to be highly supportive of the work being performed by the FASB to incorporate value measurement standards into your ongoing work. For such standards to be relevant, appropriate, and meaningful, and for them to gain market support, it is our view that they should incorporate the “best of the best” rather than to reinvent the wheel. In the real property field, for example, the very “value” that is to be reported under new measurement standards cannot and should not be something that is foreign to the markets from which it is drawn, and for which it should be both representative and definitive. We believe that this and other problems will occur in financial reporting for each of the property valuation fields mentioned above unless certain changes occur in the measurement standards and procedures cited in your ED.

Executive Summary

1. The Appraisal Institute and the appraisal profession at large strongly support the move toward current value in financial reporting. We have been involved in these issues for many decades and are cofounders of the International Valuation Standards Committee, which has established international valuation standards for financial reporting and all other valuation activities.
2. We believe that the valuation of assets and liabilities should be separated conducted independently from their ownership, reflecting values found in the marketplace rather than those measured from the perspective of a particular owner or user.
3. Asset and liability valuations should focus on the rights of ownership (or liability) rather than physical manifestations of objects. Through identification and quantification of specific rights, the assets so defined can be valued in a manner that is consistent with how they may be purchased and sold, and their values can

be reported in an accurate and consistent manner, without market confusion or misunderstanding. This concept should be explicit rather than implicit in the financial reporting standard.

4. To reach a reliable and meaningful value that is based upon market evidence and support, the concept of *market value* represents the most common understandings of the market place, the actions of market participants, and the applications of real property law in the United States. Accordingly, we believe that the long-established and more specific elements of the market value definition (discussed herein) should be substituted for those of the proposed *fair value* definition and that they will more reliably accomplish the goals set forth for the fair value concept.
5. Differences may apply in certain situations, but it is commonly the source, nature, and extent of available data that separate the methods of market-based valuations. It is therefore desirable to recognize generally accepted valuation principles (GAVP) and to assure that ethical and performance standards are established and accepted for the various valuation disciplines involved in valuations for financial reporting. Such ethics and standards have been established through the *Uniform Standards of Professional Appraisal Practice* (USPAP) for the real property, personal property, and business valuation disciplines in the United States, and also exist internationally in the standards of the International Valuation Standards Committee (IVSC).
6. The responses to the FASB's ED included herein are more lengthy than we would normally submit, but are deemed necessary because of the extent and breadth of the ED and the absence of our participation in its contents to this point. However, the comments are also only representative rather than exhaustive. Accordingly, due to the prominence of real property in the wealth of this nation as well as the world at large, and because of the Appraisal Institute's long-standing prominence in representing the interests of the public in the real property valuation field, we urgently request and recommend that we be included in more direct communication and dialog in the further development of Fair Value Measurement standards.

Background

The Appraisal Institute recognizes that the intent of the ED is to broadly establish guidance for the measurement of fair value to be applied to financial and non-financial assets and liabilities. Although the Appraisal Institute and its members are acquainted with and involved in other types of assets such as personal property and businesses, as well as liabilities, our primary focus is real property valuation; therefore, we have centered our comments on real property valuation measurement issues.

It is evident that there are language or interpretation issues that should be clarified to bridge traditional and contemporary accounting and financial regulatory terms with the robust and well-

established terms that are commonly applied in the real property field. We use the term “real property” to refer to the *rights of ownership of real estate*. Under GAAP any type of real estate ownership might be classified as an asset, but for value measurement purposes developed from the laws and customs of the real property field it is necessary that valuers (a) identify the specific rights of ownership; (b) determine the intended use of the valuation; (c) determine the intended user of the valuation; (d) identify and define the type of value to be measured; (e) specify an effective date of value; (f) ascertain that the value type is appropriate for the intended use; (g) perform the valuation competently in accordance with established ethical and performance standards; and (h) report the results in a meaningful manner with appropriate disclosures and in a form that is not misleading. Within these requirements, which are not all inclusive, valuers appraise the rights of ownership, not simply a physical asset.

Identification of the extent of the “bundle of rights” of ownership separately from the tangible real estate avoids the opportunity for multiple individuals or entities to misleadingly or fraudulently claim “ownership” of an asset or to individually report an asset’s entire value when they factually have fractional or partial ownership interests in a particular piece of real estate. If a valuer is asked to appraise an ownership in a parcel of real estate that is less than a “fee simple estate,” standards require identification of the interest as only partial and a disclosure that the value measurement is not of the entirety. Even if a valuation is rendered of a hypothetical fee simple ownership, the appraisal report should clearly state that the valuation does not apply to the components of ownership, either directly or by summation or subtraction of ratios or fractions.

The terms “asset” and “liability” imply ownership, but in our experience they are frequently not applied in accounting with the specificity of ownership rights identification that was just described. Many additional dimensions of this issue can be illustrated, but the preceding should suffice for our current comments. The principles of this illustration are, in our view, crucial to a response to the ED. This is due in particular to the non-specific terms “broadly apply” and “financial and non-financial assets and liabilities” to which the ED is directed.

The Appraisal Institute and our professional colleagues internationally are concerned about the lack of specificity of the term “fair value” as well as the issues raised above regarding the specificity of ownership interests. It is likely that these concerns are easily corrected on paper, but we sense that there are competing concepts that may make corrections more difficult. The concept of harmonization dictates that all views be heard. We are eager to hear and participate in discussions regarding value measurement issues, but urgently stress the importance of the FASB’s recognition of the enormous market role that real estate occupies in a substantial portion of the wealth of the United States and the world much of which is owned by financial reporting entities. It stands to reason that the market measurements, GAVP, and the related methodologies that have developed and continue to support value systems for real estate be recognized while sorely needed financial reporting changes are made. In the more specific comments to follow, it will be seen that we strongly support the work being done by FASB and others to achieve new and improved financial reporting standards. However, strong support includes the obligation to respond with differences as well as to offer kudos. Our comments are intended in that light.

As further background to our responses to the exposure draft we call your attention to the term “market value” as it commonly applies in the real estate and other valuation fields. We believe that, in addition to its worldwide acceptance and use, the term has specificity for application to real estate and at least certain other assets that is not incorporated in the currently offered definition of “fair value.” The definitions are highly similar, but the differences can, and have been demonstrated to, open the door to abuses that you are trying to avoid. “Market value” as a term is broadly used and understood by the market and its practitioners throughout the world. “Fair value” has what we believe to be a less commonly understood meaning in the context of financial reporting, and lacks the specificity as market value. We hope you will take particular note of the enormous financial losses that were created by the Resolution Trust Corporation’s use of the “fair value” in disposing of real estate at far less than market value, exacerbating an already serious national economic disaster. It may be that harmonization should occur in the definition, if not in the terms.

Domestic and International Valuation Standards

The measurement of value has recognized GAVP for many decades in the United States, Canada, and many countries of the world. The foundations for these principles and accompanying standards are based in classical and neo-classical economics, but more modern developments had their birth as means of overcoming fraud, abuse, and malpractice associated with the Great Depression. They have subsequently evolved globally over the remainder of the past century.

Recognizing a need for international standards to support accounting and financial reporting, the Appraisal Institute co-founded The International Assets Valuation Standards Committee in 1981. The group, which has since been renamed the International Valuation Standards Committee (IVSC), became a Non-Government Organization Member of the UN in 1985 and has worked for several decades with the International Accounting Standards Committee (now Board) to harmonize and improve upon standards in the valuation profession and financial reporting. The IVSC’s initial international standards were explicitly developed for financial reporting and were later expanded to assure that the same standards were applied in all professional property valuation worldwide. More than 50 nations are now active in IVSC’s work, and together GAVP and International Valuation Standards (IVS) are recognized worldwide.

Simultaneous with the development of international standards, professional valuation organizations in the United States began to develop comprehensive and uniform valuation standards that were incorporated into Congressional reform activities directed to resolving the banking and savings and loan crisis of the late 1980s. These efforts produced national recognition of the *Uniform Standards for Professional Appraisal Practice* (USPAP), now enforced through state laws under the oversight of Congress. State licensing and certification of real property appraisers is required in all states and territories, as is the enforcement of USPAP. If the FASB were to create new and different measurement standards for real property valuations, it would create legal and other conflicts, controversy, and market disruption that are unnecessary. These issues will be addressed below.

A reason that formal valuation standards developed rapidly, and have been so widely accepted throughout the world, is the discovery that GAVP had long existed in most of the major countries of the world. The issue was not sudden development of standards—it was their more recent articulation and formal adoption. In the United States, for example, market value opinions have been a cornerstone of mortgage finance, purchase and sale of real and personal property assets, eminent domain, “fairness issues,” and basic business valuation for many decades. Hundreds of thousands of practitioners and countless clients, courts, and others understand and rely upon professional valuations, market value concepts, and their market value methodologies. Major institutional investors require market value valuations of real property assets in their portfolios to occur as frequently as monthly.

Although these background comments scarcely scratch the surface of the history and ongoing market relevance of professional valuers, and particularly their market value opinions, they should suggest that failure to incorporate into financial reporting standards the principles, methodologies, and dependencies of those who own, buy, sell, or finance real property, or who otherwise deal with such value opinions, could have serious market consequences. Conversely, and this is our principal message, *we believe that the strengths of these foundations can be readily accommodated in the proposed fair value measurement standards and thereby facilitate their successful implementation, while protecting the public trust that we, too, are dedicated to uphold.*

Discussion of FASB Exposure Draft Issues

Issue 1: Definition of Fair Value and Unit of Account

The “fair value” definition incorporates many of the elements of a “market value” definition, but lacks needed specificity because of the omissions. Further, where value is concerned, it appears to us that “fairness” is not an issue if financial reporting of asset and liability values is to be independent, unbiased, and representative of values from the marketplace. The notion that what is fair to one reporting entity might not be fair to another implicitly suggests that the degree of, or opportunity for, special interest fairness should be avoided, even semantically.

For reference, three definitions of market value are cited below. Let us emphasize that, while the wording of these definitions differs because of jurisdictions, current worldwide harmonization in the definition is occurring and the concepts are considered highly similar, if not identical, when explanatory comments are added for each.

1. “The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.” *International Valuation Standards, 2003*. International Valuation Standards Committee. “General Valuation Concepts and Principles.” p. 38.
2. “The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer

and seller each acting prudently and knowledgeably and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby:

- a. buyer and seller are typically motivated;
- b. both parties are well informed, or well advised, and acting in what they consider their best interests;
- c. a reasonable time is allowed for exposure in the open market;
- d. payment is made in terms of cash in United States dollars or in terms of financial arrangements comparable thereto; and
- e. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.”

The Appraisal of Real Estate, 12th Edition. Appraisal Institute. Chicago, p. 23, citing *Federal Register*, vol. 55, no. 163, August 22, 1990, pages 34228 and 34229, and others.

3. “...the amount in cash, or on terms reasonably equivalent to cash, for which in all probability the property would have sold on the effective date of the appraisal, after a reasonable exposure time on the open competitive market, from a willing and reasonably knowledgeable seller to a willing and reasonably knowledgeable buyer, with neither acting under any compulsion to buy or sell, giving due consideration to all available economic uses of the property at the time of the appraisal.” *Uniform Appraisal Standards for Federal Land Acquisitions* (UASFLA). Interagency Land Acquisition Conference. Washington, D.C. 2000. p. 13.

USPAP requires all real property valuation professionals to state whether a market value opinion is developed on a cash basis or upon the basis of specified terms. The differences can be highly significant and should be included in the appropriate value definition and related disclosures. If a basis other than a cash or cash-equivalent basis is chosen—if such alternative basis is permitted at all—this should be the subject of financial and auditing review and comment.

USPAP requires that the effective date of value be incorporated into a market value opinion. Differences of dates can be highly significant and a specific date of value should be included in the appropriate value definition. We believe that the date should be disclosed and that variations in valuation dates should be the subject of financial and auditing review and comment.

Absence of relationship between the buyer and seller is recognized in the current fair value definition proposal, but with the complexities of business combinations we believe the definition of value, and the standards related thereto, should be more precise regarding the obligations of reporting entities to disclose relationships that disinterested third parties may consider significant or meaningful.

Please note that various market value definitions refer to the need to recognize a time period for exposure to the open market prior to completion of the sales transaction. It is our view that this distinction is a necessary addition, at least to the explanations of the final wording of the value definition, because it recognizes that not all assets are optimally sold on a spot market. Market understanding and consistent reporting are not promoted if one asset is valued on the basis of immediate liquidation while a similar asset owned by a different entity is valued based on a six-month exposure to the market if that is appropriate. Further, as specified by USPAP, we recommend that marketing time be an element of all valuation opinions and reporting. Without such standards it is possible for assets to be over- or understated as of an effective valuation date. This can foster misunderstandings or abuses in financial reporting.

The “unit of account” issue is particularly important in real property asset valuation. A shopping center may sell for one figure representing market value in a single property purchase and sale transaction, but may have a different contributory value if sold as a part of a portfolio. (The same is also particularly true with combinations of personal property.) When sold as part of a portfolio the shopping center is considered as part of an arbitrarily chosen and variable security—the portfolio ownership—rather than as a bundle of rights to the individual property. Thus, financial reporting could be approached in either manner, but with significant opportunity for misunderstandings or misrepresentations. Based on our experience with institutional investors who regularly deal with individual properties and portfolios, it is our recommendation that the unit of account for real property assets be established at the property-specific bundle of rights level. Thus, in the above example, the market value of the shopping center would be the basis of valuation reporting. To the extent that portfolio issues arise, those are akin to other business value or financial management related issues and may have infinite variations, while the recognition of asset market value at the property level seeks, and reflects, the individual value at the parcel level.

If real property assets were to be valued on a combination basis rather than individually, elements of the business would be valued rather than the real property rights of the assets themselves. This, in our view, compounds asset accounting issues including, but not limited to, depreciation. Value reporting would reflect how the reporting entity considers the combination of assets contributes to the overall value of the firm rather than leave that determination to the net effect of all assets and liabilities valued at the individual level. We have heard that such valuations would be onerous because they are time-consuming, expensive, and problematic. We strongly disagree and offer the example of the National Council of Real Estate Investment Fiduciaries (NCREIF), the investment management of many institutional investors in the United States, and an organization who affirms the importance and practical attainability of market value opinions by requiring property index contributors to have full USPAP-compliant, market value property valuations on a regular basis. Accounting is performed at the asset and liability level and should be able to readily accommodate accurate and reliable valuation requirements. Without more rigorous reflection of market supported values for assets and liabilities, the cost of uncertainty is transferred to market investors and the economy at large, and may far surpass the effective cost of simply reporting accurate values that investors can rely upon as they analyze business performance.

Issue 2: Valuation Techniques

We concur that the “three approaches to value” as they are called in the valuation profession are appropriate valuation techniques. USPAP requires that all three approaches be considered “*when appropriate and applicable,*” and that deletions of one or more approaches should be supported and explained by the valuer.

The example offered in the ED involving quoted prices in active markets could be misunderstood where real property is concerned. Quoted prices for real property are typically higher than bid and eventually agreed-upon prices, but can be less than eventual sales prices in certain unique market circumstances. Thus, spot market prices that may exist for securities, commodities, or other formal markets will rarely be found for real property assets. We agree with the page 3 footnotes and recommend expansion of the explanation in the final document.

With regard to the ED’s explanation of the three “valuation techniques,” which we refer to as “approaches” because each has a variety of techniques that can be applied in keeping with GAVP, we have a number of differences to point out.

First, all of the approaches are “market approaches” if they are to be supportable as independent indicators of market value. Usually they are applied in combination for real property valuation to test the market opportunities, if not factual use, of the Principle of Substitution (of market choice). We offer the following brief comments regarding each in response to your ED:

1. The **Sales Comparison Approach** for real property valuation relies primarily upon completed transactions, which are qualified for their fit to the market value definition prior to further analysis. Cash-equivalency prices are commonly calculated when special financing terms are involved. GAVP specifies how offerings, listings, and other market evidence may be considered. GAVP and standards also establish requirements for application of this Approach. Real estate has uniqueness in its fixity of location and general absence of mobility, but elements of and procedures for proper comparisons of these and other factors that are important to pricing and value are generally accepted not only by appraisers but also by clients and the market as well. Importantly, physical and economic considerations are important to the processes, but it is the rights of ownership that are ultimately valued. These can vary widely among otherwise comparably constructed, maintained, and located physical assets.
2. The **Income Approach** for real property valuation requires a separation of the net income attributable to real property ownership from that of a specific owner or a business that may occupy or use the property. Typically, revenues and expenses are “stabilized” so as to represent typical year operations, but with proper data and disclosure a discounted cash flow procedure can be applied by reflecting annual anticipations as supported by appropriate market information. Discounting processes are applied through various generally accepted techniques, but do not include option pricing or Black-Scholes-Merton models as these are considered not to derive property specific discount rates that are representative of or generally supported by real property markets. We have observed many incorrect and misleading applications of such models, which have resulted in over valuation of real estate assets and have been unsupported in the demonstrable markets

for real property assets. These models are examples of our concern expressed above that procedures incorporating analysis or consideration of the business of the owner are inappropriate as a general procedure for asset valuation for a number of reasons.

3. The **Cost Approach** has many applications in real property valuation, although it is less likely to be significant contribution in already developed urban areas where land prices are scarce. Cost Approach applications are of particular use in considering new or relatively newly constructed real estate assets and in valuation of limited or non-market properties. These are complex issues that require more discussion than this response. For example, the European (and former international accounting) concepts of Market Value for the Existing Use and application of a Depreciated Replacement Cost approach (DRC) are well known to us, but deserve considerably more exploration than this response to your ED.

We concur with paragraph 8 of Valuation Techniques in your ED and believe that additional steps such as suggested herein may serve to ensure consistency, accuracy, and reliability in asset and liability valuation. It is a premise of our remarks that valuation reporting standards should distinguish between the asset and the owner. While the specific rights of ownership are a crucial element of the valuation, real estate valuation standards specify that ownership should be viewed from the perspective of the value definition (normally “the market”), not the specific reporting or ownership entity.

Issue 3: Active Markets

Individual assets such as real estate and many types of fixed assets do not customarily trade in an efficient market environment where market inputs, including immediate access to market prices which are representative of value for the given asset, are readily and regularly available in the sense of stock and bond exchanges (Exchange Markets). Market inputs refer to the assumptions and data that marketplace participants use in their asset pricing that ultimately forms the basis for market value. To avoid confusion and misleading results, market inputs must be clearly defined and directly related to the valuation assignment.

The proposed ED statement should be specific in language defining what constitutes an “active” market input and the degree of relative acceptance. In real estate valuation practice, the exclusive use of quoted prices as market inputs is not acceptable without the inclusion of actual closing prices and an understanding of other elements specified by the market value definition. Bid pricing is rarely available. Active markets include Exchange and Dealer markets as defined in “Market Inputs,” section 11a and 11b (page 4), but would likely not include Brokered markets or Principal to Principal markets. Further clarification is suggested to assure that all asset and liability categories are included.

To the extent that not all assets and liabilities are capable of valuation under the assumption of “efficient frontier” pricing, purchase, and sale, accommodation must be made for the respective market circumstances if a market standard is to be meaningful. It is our view that the vast majority of valuation situations are capable of market support, even in limited market situations. Further, the results are considerably more meaningful and less capable of misrepresentation or other abuse than historical cost accounting, even with modified depreciation methods. The

market that is active for given assets and liabilities may, and frequently will, be different than the equity market for corporate ownership. Over the history of economic cycles in the United States we have observed less volatility in the local markets for real estate than in the business cycles that surround them. Thus, the same market that is recognized in the “market value” for assets is independent of the particular owner or reporting entity. Proper consideration of this asset-specific market is an integral component of professional valuation, and the disclosures and explanations of such market provide a dimension, and potential for stability, not generally available otherwise.

Issue 4: Valuation Premise

We concur with the proposed Statement that a valuation premise specifies the condition and location of many assets and provides additional information about the asset being measured, along with the assumptions that marketplace participants would use in their estimates of value. The professional valuation community is bound by professional appraisal standards to clearly define the valuation premise for every assignment undertaken. Further, such professionals are required to assure that the premise is appropriate for the intended use of the valuation report and that the report is structured so as to avoid its use in a misleading way. Generally accepted valuation principles include the following sample premises as defined in *The Dictionary of Real Estate Appraisal*, 4th Edition, Appraisal Institute, 2002:

Going Concern Value

1. The market value of all the tangible and intangible assets of an established and operating business with an indefinite life, as if sold in aggregate; also called value of the going concern.
2. Tangible and intangible elements of value in a business enterprise resulting from factors such as having a trained work force, an operational plant, and the necessary licenses, systems, and procedures in place.
3. The value of an operating business enterprise. Goodwill may be separately measured but is an integral component of going-concern value. (USPAP, 2002 ed.)

Use Value

1. In economics, the attribution of value to goods and services based upon their usefulness to those who consume them.
2. In real estate appraisal, the value a specific property has for a specific use; may be the highest and best use of the property or some other use specified as a condition of the appraisal; may be used where legislation has been enacted to preserve farmland, timberland, or other open space land on urban fringes. See also exchange value; value in use.

Investment Value

The specific value of an investment to a particular investor or class of investors based on individual investment requirements; distinguished from market value, which is impersonal and detached. See also market value.

Liquidation Value

The net amount that would be realized if the business is terminated and the assets are sold piecemeal. Liquidation can be either "orderly" or "forced."

Each of these valuation premises (and others) is founded as an exception to the basic concept of market value, with market or other inputs from sources that are appropriate to the premise. We suggest that the Statement be broadened (with examples) to include additional premises that may be encountered in standard practice of valuations for financial reporting to distinguish them from those required for financial reporting. Note, for example, that the IVSC has taken international notice of the importance of market value above all other types by structuring its standards to feature market value (IVS-1), with all other valuation bases included as an exception in IVS-2. We believe this fairly represents the view of United States markets as well. This is evidenced in the special attention given to market value in USPAP and in the federal government's UASFLA.

Issue 5: Fair Value Hierarchy

The Appraisal Institute is sensitive to the reasons why a "fair value hierarchy" was established, but strongly urges a different approach that combines the rationale for this hierarchy with principles that are more consistent with GAVP.

USPAP standards require consideration of all three valuation Approaches (Sales Comparison, Cost, and Income), and recognize that market circumstances will dictate the evidence that is available, relevant, and meaningful. Thus, the appropriateness of valuation approaches is a reflection of the market itself, not a rule that is to be superimposed upon the market. The approaches selected and applied are explained and justified in each valuation report in accordance with these standards.

Our experience indicates that a hierarchy of supportive data, explanation, and disclosure emerges as data become less available, relevant, and/or meaningful. Our profession believes, in a colloquial sense, that "the last thing the client should be concerned with is the value opinion," because of the primacy of the ethics, standards, GAVP, available data, competency, and professional expertise that must be evidenced in its development. One does not drive across a bridge because it looks pretty and spans a river. One does so only after satisfaction that it is safe and functional. The same is true with books of account and the financial statements that are based upon them, as it is for professional value opinions.

Thus, we urge a reconsideration of the entire concept of the hierarchy, with which we do not disagree, but believe can be improved upon with reasonable additions and some redirection.

Issue 6: Reference Market

Issue 6 pertains to Level 1 estimates where market inputs are quoted market prices that are easy to obtain and are reliable and verifiable. We caution that care must be taken and assurances given that the market data source utilized provides direct evidence of value to avoid confusion and misleading results. This market input source becomes a critical issue in Level 3 estimates and significant judgment will be required. Proper disclosure is an essential element in valuation reporting.

In practice we have observed confusion over “market” concepts, which can be especially harmful under a fair value definition that lacks specificity. For example, forced sales, bulk sales, sales of portfolios, and allocations of asset values from the sale of a business can mislead as indicators of asset market values. GAVP and related valuation standards are crafted to avoid these misunderstandings and misapplications, but absent appraisal standards, accountants and auditors may not have the same training and understanding.

Issue 7: Pricing in Active Dealer Markets

As explained elsewhere in our response, the Appraisal Institute’s members are primarily involved in real property markets in which “active dealer markets” in the sense of securities markets rarely, if ever, exist. We note, however, that the analysis of bid and asked prices must be related to the underlying markets they represent. This is a fundamental economic concept applicable to all markets and suggests that the establishment of “rules” for value determinations is inadvisable and may lead to abuses and/or misleading results.

It is also necessary to recognize that the denominations or quantities of what is being purchased and sold, transaction costs, asset delivery, warranties and return policies, and many other factors may complicate the nature of what is factually being purchased and sold, thereby complicating rule-based accounting and reporting. This is especially true if assets are reported only on a line-item basis without regard to the rights that accompany and define them.

Issue 8: Measurement of Blocks

Please see our response to Issue 7, above.

Issue 9: Level 2 and 3 Estimates

As defined, Level 3 estimates rely on the results of other valuation methodologies including the Market Approach, Income Approach and Cost Approach. To remain consistent with internationally accepted valuation terminology, we would suggest that you refer to the “Sales Comparison Approach” in place of the proposed “Market Approach.” As mentioned before, the three traditional approaches to value are actually *all* “market approaches.” Trained valuers worldwide recognize these approaches and are schooled in the proper implementation of the techniques for daily application in valuation assignments. We recognize the practical concerns about the reliability of Level 3 estimates because they require more estimation and assumptions, and appear to be more subjective than Level 1 and Level 2 estimates, but the process has been recognized and accepted for centuries in financial markets around the globe. In part this acceptance has arisen from the

development of a valuation profession, and recognition has grown as valuation standards have been developed in the United States and elsewhere.

To mitigate these concerns, the Statement requires that Level 3 estimates be based on the results of multiple valuation techniques “generally 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.” The three approaches to value are established in the professional valuers’ Body of Knowledge and should be applied under GAVP. Wavering from these rules and standards by applying “generally consistent” techniques invites an unreliable result.

We agree that the reliability of Level 3 estimates depends on the reliability of the inputs used. This is true of any analysis. We can only infer the basis you have in mind for the concept of applying data from different markets if data are not otherwise readily available, but suggest consideration of the following. A market value is either supportable from market data or it is not. If it is not supportable, a disclosure of that fact is likely to be more significant than any number that can be reported. Using an example of just compensation under the Fifth Amendment, if no market value can be supported because of the uniqueness of the property or circumstances, the courts have looked to other “equivalents” rather than to presume that value does not exist. In such instances, just compensation can still be determined, and paid, by looking to other equitable measures. GAVP provides a basis and methodology for analysis and reporting in such situations, as well as requirements for special discussion, support, and disclosures. We believe that there are similar arguments to be made for the information that should be provided to the users of financial reports, who should be made aware of significant issues in asset and liability value reporting, and how they were addressed by the reporting entity.

The ED states that in some cases:

“...relevant market inputs for assets and liabilities that are not exchanged in active markets might not be available without undue cost and effort, requiring the use of significant entity inputs.” Paragraph 38 of Concepts Statement 7 explains:

‘an entity that uses cash flows in accounting measurements often has little or no information about some or all of the assumptions that marketplace participants would use in assessing the fair value of an asset or liability. In those situations, the entity must necessarily use the information that is available without undue cost and effort in developing cash flow estimates. The use of an entity’s own assumptions about future cash flows is compatible with an estimate of fair value, as long as there are no contrary data indicating that marketplace participants would use different assumptions. If such data exist, the entity must adjust its assumptions to incorporate that market information.’”

We caution that care must be taken that “undue cost and effort” not become the primary reason for the exclusion of market-derived inputs as it invites more subjective analysis and significantly increases the chance for error. It is recommended that Level 3 estimates for real property

ownerships be based on GAVP and related standards. Again, we note that international standards are also available through IVSC.

Issue 10: Restricted Securities

Valuation of securities *per se* is beyond the scope of real property valuation, but the principle of restrictions upon free and open marketing of ownership interests is common to both. Certain real property interests may not be marketable at all because of restrictions on marketability. This is one of the reasons why an owner in possession may have an investment value or value in use (defined above) in an asset that has no market value.

Under GAVP a distinction is drawn between the value of real property ownership held in fee simple title and the valuation of fractional interests. Frequently it is possible to find market data, and even active market trading, for fractional interests in real estate, but such interests must be examined to determine whether they are securities, and hence not solely real property rights, or real property alone. Although lack of liquidity intuitively suggests a discount when compared with no such restriction, certain market circumstances may demonstrate that a premium is sometimes paid because of other overriding market considerations. Thus, as stated in the ED, no automatic formulas exist. Instead, it is the Appraisal Institute's view that these special circumstances should be analyzed under identified standards, with requirements for explaining the market support for the conclusions along with necessary disclosures.

We are aware through the practices of a number of our members who are active in accounting, securities fields, and elsewhere that considerable research has been performed in the area of discounting that may be associated with the valuation of restricted stocks. Such studies include the SEC's *Institutional Investor Study*, studies performed by Gelman, Moroney, Trout, Maher, Silber, and others. It appears that most studies attempt to quantify a discount taken against the freely traded price of minority shares in the public market. As is true with real property, it is our view that any basis should stand the test of the value definition, and that the market value definition provides elements that should aid in defining relevant, reliable, and supportable value opinions for other assets as well.

Issue 11: Fair Value Disclosures

We particularly support FASB actions to expand disclosures that promote market understanding of reported asset and liability values. The real estate valuation profession's long history of independent value reporting has featured requirements for specified disclosures and others that, in the judgment of the valuer, will promote understanding and proper use of appraisals. We believe such disclosures are important protections of the public interest, while they promote market confidence.

FASB's emphasis on the need for increased consistency and comparability in fair value measurement is well founded, as is the need for enhanced disclosure requirements. However, we urge FASB to recognize that differences among asset and liability classifications may raise different disclosure needs. Differences in real property classifications, ownership positions, and other factors are reasons why appraisers have ethical responsibilities to disclose beyond the

range of required disclosures, when necessary, and we recommend that concept for your consideration in other asset and liability classes as well.

The Investment Performance Council of the CFA Institute (formerly the Association for Investment Management and Research) recognized the issues that may arise in valuation reporting, including the need for proper disclosures, in their 'Gold' Global Investment Performance Standards. Their standards recognize the need for independent third-party performance measures and the value of requiring real estate property investments to be valued by professionally designated, certified, or licensed valuers/appraisers. Their requirement that external valuations be independently completed pursuant to applicable valuation standards appears to eliminate potential conflict between the auditor and valuer functions, and is an important disclosure topic.

USPAP distinguishes between assumptions, extraordinary assumptions, and hypothetical conditions. An assumption is that which is taken to be true and is based on most reasonable and likely evidence. An extraordinary assumption is an assumption, directly related to a specific assignment, which, if found to be false, could alter the appraiser's opinions or conclusions. A hypothetical condition is that which is contrary to what exists but is supposed for the purpose of analysis. Standards require disclosure and identification of the existence of any of the three, and prominent disclosure of the latter two is also required anywhere that a reported conclusion of the appraisal is displayed. Both ethical rules and standards apply. Appraisal standards have severe restrictions on the use of hypothetical conditions, which are particularly problematic where market value is involved. It is our opinion that these rules, standards, and general safeguards are crucial for market value opinions and that they are even more necessary to the extent that a less explicit definition of fair value might be used.

Issue 12: Effective Date

We support the activities of the FASB toward implementation of a June 15, 2005, effective date and will pledge the support and collaboration of our organization and its members toward that goal. Through our work with other professional valuation organizations in the United States, Canada and elsewhere, we can assure the FASB that the valuation profession globally will assist towards that aim.

Issue 13: Other Issues

We have addressed a number of "other issues" in the preceding comments. Especially important are the issues of specificity in the value definition, rights of ownership as the subject of asset valuation rather than physical attributes or manifestations alone, and consideration of market buyers and sellers in valuation rather than the business or other provincial perspective of the owner.

The extent to which, in order to assure independence and consistency in financial reporting, that the market value of individual assets and liabilities will be used in future reporting standards is a crucial issue to be determined. We believe there are many related issues, but reserve the opportunity to discuss these later in conjunction with more direct communications as we have invited above.

Issue 14: Public Roundtable Meeting

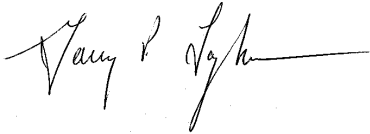
The Appraisal Institute is interested in participating in a public roundtable meeting on September 21, 2004, or such other date you determine appropriate. We have attempted to be somewhat expansive in our remarks herein to assist you in understanding the direction and nature of comments we will express at such a meeting. In turn, we are eager to meet with you and your staff prior to such a public roundtable meeting to discuss any or all of our responses and other issues that we believe the FASB should consider.

About the Appraisal Institute

The Appraisal Institute is an international membership association of professional real estate appraisers, with more than 18,000 members and 99 chapters throughout the United States, Canada and abroad. Its mission is to support and advance its members as the choice for real estate solutions and uphold professional credentials, standards of professional practice and ethics consistent with the public good.

Again, thank you for considering our comments. If you have questions, please don't hesitate to contact Alison Gerlach, Manager, Special Projects, at 312-335-4116 or agerlach@appraisalinstitute.org.

Respectfully Submitted,



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International Valuation Standards Committee

Sir David Tweedie, Chairman
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Gregory L. Fletcher, Assistant Chief Auditor
Mary M. Sjoquist, Special Counsel
Public Company Accounting Oversight Board

Peter J. Martin, Principal
Canadian Accounting Standards Board

The Honorable Michael G. Oxley
The Honorable Barney Frank
House Committee on Financial Services

Thomas A. Bowman, President & Chief
Executive Officer
CFA Institute

The Honorable Joe Barton
The Honorable John D. Dingell
House Committee on Energy and Commerce

The Honorable Richard Shelby
The Honorable Paul Sarbanes
Senate Committee on Banking, Housing and
Urban Affairs