# FEDERAL RESERVE BANK OF SAN FRANCISCO

December 23, 1940

PERSONAL AND CONFIDENTIAL

Mr. Lawrence Clayton,
Board of Governors of the Federal Reserve System,
Washington, D. C.

Dear Larry:

In the hypothetical case set forth in your letter of December 11, I think you have lost sight of one of the fundamental principles contained in Paragraph 5 of the Bank of America Agreement.

According to the Agreement--

The absorption of goodwill by writing up the value of a building was definitely regarded as improper. The carrying value, as shown by the books of the selling bank, was to be accepted if it came into the buying bank at the same amount. If the amount was greater, the Committee must "consider the special conditions which had to be met in fixing the price paid" at the time of acquisition. It is not possible to determine by present-day appraisement what a property was worth at the time of acquisition ten or twenty years ago. However, the existence of a write-up lays the burden of proof of its necessity upon the Bank of America. In considering the facts presented, the Committee shall consider whether the price paid at the time of acquisition was a fair value. For instance, if the sellers of a bank (assets or stock) refused to accept the price offered unless a greater value be given the building than that at which it was being carried on the books of the selling bank, the price agreed upon should be accepted. The Committee members, however, must assure themselves that such an agreed price was not weighted by something unrelated to the value of the building.

You must have misread my telegram to Mr. Dreibelbis of October 9. It contains no reference to the establishment of "current values."

You must keep in mind that appraisement of the bank premises as a procedure for determining the present asset value was eliminated early in our Washington discussions. The bank's carrying value was considered acceptable, provided properties as such were free of "write-ups," and provided they had been depreciated properly since the time of acquisition. It should not be overlooked that the $6,900,000 reserve is carried as a contingency and not as a valuation reserve, so it is necessary to determine how much has to be eliminated to make a proper showing of the bank's capital structure.

I cannot quite agree that, if an asset is written up on the books of a bank to a point beyond its value, a reversal of such entry is merely bookkeeping. By the accounting process, it is possible neither to create values that do not exist, nor to extinguish values that do. If you have not got something, you have not got it, accounting or no accounting. On the other hand, if you have something, you have it, whatever you do to your books to conjure yourself.

There is enclosed a memorandum dated May 8, 1940, which I prepared for the guidance of the Committee.

With best wishes for a merry Christmas for yourself and family,

Yours very truly,

M. Clerk

Enclosure.