

# Rulemakers Try To Close Gaps In Fair Value

By Tammy Whitehouse

Accepting the reality that fair value is in growing demand in financial reporting, policy makers are now turning their attention to how to make it work.

In a span of a few short weeks, accounting rulemakers formed a new body to help figure out where more guidance is needed; the prevailing accounting professional group published the first in what may become a series of new standards focused solely on valuation; and audit regulators debated how to get the auditing profession up to speed.

The flurry of actions reflects the steady evolution of the global business economy, says Brian Markley, managing director for CFO services firm SolomonEdwardsGroup. Fifty years ago, the primary business model focused on physical assets and financial capital; today's models revolve more around intangible assets and intellectual capital.

"That evolution in business has made historical basis accounting for assets and liabilities increasingly disconnected from the real financial position that companies maintain," Markley says. "Fair value is an answer for bringing companies' financial statements back in line with the reality of what their businesses are, and that is increasingly made up of intellectual, intangible assets and liabilities."

The Financial Accounting Standards Board has already added some significant building blocks to U.S. Generally Accepted Accounting Principles, prodding the market toward greater use of fair value. Its most recent additions were Financial Accounting Standard No. 157, *Fair Value Measurements*, and FAS 159, *Fair Value Option for Financial Assets and Financial Liabilities*.

But the Board arrived at a crossroads earlier this year, unsure how best to proceed in providing guidance on valuing company assets—a process inherently steeped in estimates, assumptions, and judgments. When FASB asked the market for opinions on where to focus its efforts and how to offer new guidance, the Board

received more than 80 comments letters with advice all over the map.

FASB responded by forming a "resource group," a body that will advise the Board on where guidance might help clarify issues related to existing fair value measurement rules. It hopes to convene the panel for the first time in the third quarter of 2007.

## Other Voices Chime In

While FASB wrestles with how to proceed, the American Institute of Certified Public Accountants has published a new authoritative statement of its own: AICPA Statement on Standards for Valuation Services No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset*.

In the GAAP hierarchy, AICPA guidance doesn't undo or compete with anything FASB publishes, but it obliges AICPA member accountants—all 330,000 of them—to employ the standard's methods and guidelines for developing estimates of value.

Michael Crain, chair of the AICPA Business Valuation Committee, says the AICPA standard is meant to guide accountants through the valuation of an asset or a liability for which there are no observable market benchmarks for establishing a value. In the valuation hierarchy established by FAS 157, that's the most difficult calculation of valuation, requiring judgment and experience, Crain says.

"In the area of fair value measurements, the GAAP literature published by FASB has been principles-based," Crain says. "A number of people have asked for more specific guidance about how to actually implement those principles. This standard does not expound on GAAP, but it provides clarity with the core methodologies."

It is the first standard on valuation services published by the AICPA (evidenced by its numerical order), but Crain says no specific plans exist to publish other standards at this time. "The numeric series is just a tradition of the AICPA," Crain says. "There's nothing on the agenda right now to publish a second standard."

Advocates for those who read and rely on financial statements are encouraged by the current direction and eager for a time

when financial reporting will become more consistently based on fair value measures. Georgene Palacky, director of the Financial Reporting Policy Group for the CFA Centre for Financial Market Integrity, says current rules allowing companies some flexibility in where they use fair value versus historical cost are an obstacle to comparability among companies.

---

"A lot of these issues have been around for decades ... Sometimes the answer [to a fair value question] just isn't what companies want to hear because they say it creates volatility. What it does is make inherent volatility more apparent, instead of allowing it to be smoothed over time."

—Georgene Palacky,  
Director,  
Financial Reporting Policy Group,  
CFA Centre For Financial  
Market Integrity

Guidance that steers the market toward some common, consistent approaches in valuation will be welcome, she says.

"A lot of these issues have been around for decades," she says. "Sometimes the answer [to a fair value question] just isn't what companies want to hear because they say it creates volatility. What it does is make inherent volatility more apparent, instead of allowing it to be smoothed over time."

Richard Braun, managing director for FTI Consulting, is another advocate for greater use of fair value. "You can make a lot of arguments for how fair value is not the perfect answer, but it's the better answer to historical cost," he says. "Many things are done on the basis of fair value: investments, transactions, taxes. The val-



Markley

uation opinion greases a lot of things. It's not perfect or without flaws, but it's a better process than relying on historical cost or some formula applied with little or no judgment."

### Gaining Experience, Expertise

The learning curve is a common concern in the growing use of fair value. Companies need to learn how to establish values, especially when there are no market benchmarks, and auditors need more training to adequately audit those values, Crain says. "With any emerging area such as fair value measurements, there's going to be a period of time to transition."

It should not, however, serve as an obstacle to the rulemaking process, says Palacky. She notes that even Big-4 firms stumble in fair value calculations, as evidenced by recent inspection reports from the Public Company Accounting Oversight Board. "I'm not sure this should be a barrier to entry," she says. "It's something that needs to be addressed."

Braun says the market not only needs more experience and expertise in reaching fair value measurements, but also needs caution to assure they are reached independently, without undue bias or pressure. Audit firms can't provide valuation services to audit clients without violating audit independence rules, so companies must reach their own valuation conclusions or hire outside help. Ultimately, Braun says, it will be up to the audit firms to assure the valuation conclusions are defensible.

That raises questions at the PCAOB about whether auditors are adequately trained in valuation techniques to provide that assurance. The PCAOB turned to its Standing Advisory Group recently for advice on whether it needed new auditing standards around the growing use of fair value.

The advisory group discouraged the PCAOB from heaping new audit rules onto an already burdened regulatory process. Instead, it called for more guidance, education, and training to address the knowledge gap.

"Valuation is an art, not a science," Braun says. "It will be important for the accounting firms ultimately, since they're the ones that have to attest to the statements themselves, to provide some qual-

ity assurance."

For more information, including the latest news on efforts to standardize valu-

ations, please go to [www.complianceweek.com](http://www.complianceweek.com) and enter **Print Reference Code: 090711**. ■

### VALUATION FAQs

Below is some question-and-answer guidance from the American Institute of Certified Public Accountants on its new valuation standard. For additional information, go to [www.complianceweek.com](http://www.complianceweek.com) and enter **Print Reference Code: 090711**.

#### WHAT IS SSVS NO. 1?

The Consulting Services Executive Committee (CSEC) of the American Institute of Certified Public Accountants (AICPA) released Statement on Standards for Valuation Services No. 1 (SSVS No. 1) "Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset." SSVS No. 1, or the Standard, is intended to provide AICPA members guidelines for developing estimates of value and reporting on the results. It applies to AICPA members who perform an engagement that estimates the value of a business, business interest, security, or intangible asset for numerous purposes, including sales transactions, financing, taxation, financial reporting, mergers and acquisitions, management, and financial planning and litigation.

#### WHERE CAN ONE GET A COPY OF SSVS NO. 1?

A copy of SSVS No. 1 is available on the AICPA Web site. Additional implementation resources can also be found in this same section of the BVFLS Web site.

#### WHEN DOES SSVS NO. 1 GO INTO EFFECT?

SSVS No. 1 is effective for engagements accepted on or after Jan. 1, 2008.

#### WHY IS THE AICPA ISSUING SSVS NO. 1?

The AICPA developed the Standard to improve the consistency and quality of practice among its members who perform engagements that estimate values. Congress, government agencies, and accounting regulators have recently focused their attention on appraisal issues—such activity shows the importance of valuation to the business community and individuals. The Standard promotes greater transparency and provides our members with a set of guidelines in the unique context of a CPA practice. In addition, an increasing number of CPAs offer valuation services.

The demand for valuation services has significantly increased over the past 20 years. The Standard should benefit the public because it promotes consistent practice among CPAs performing valuation services and adequate disclosures for users of these services.

Based on years of deliberation and debate encompassing numerous groups within the AICPA, SSVS No. 1 provides professional guidance that encourages consistency, transparency, communication, structured service levels, and well-defined reporting options for members, clients, and other users.

#### TO WHOM DOES SSVS NO. 1 APPLY?

SSVS No. 1 applies to all AICPA members who perform valuation services for various purposes (such as transactions, financings, taxation, financial accounting, bankruptcy, management, and financial planning and litigation) as well as for various disciplines in the profession (including consulting, litigation services, personal financial planning, tax, and accounting). The Standard contains several exceptions when the requirements do not apply. All AICPA members, regardless of discipline, should follow SSVS No. 1 when they perform an engagement or any part of an engagement that estimates a value resulting in an expression of either a conclusion of value or a calculated value, unless a specified exception applies to them.

Source: AICPA.