

COMPLIANCE WEEK

More Sparring Over Fair Standards for Valuation

By Tammy Whitehouse — August 14, 2007

In the ongoing debate over how to unravel unnecessarily complicated accounting rules, nobody wants to hit the “delete” key for valuation standards. Instead, much of the market is crying for *more* guidance and rules around valuation to corral a herd of divergent approaches.



Bowerman

“Transparency? I feel like I’m looking through a piece of glass painted black,” quips David Bowerman, president of CBIZ Valuation Group, which regularly produces valuations for financial reporting purposes. “There’s a great deal of ambiguity [and] little guidance, and it’s morphing every day.”

The importance of valuation to financial reporting has reached new heights in recent years as the Financial Accounting Standards Board has increasingly called for certain assets and liabilities to be reported at fair value, turning away from the clear-cut approach of carrying such figures at historical cost. Historical cost estimates can sometimes belie the true current cost of an asset, such as real estate purchased long ago.

Yet the standards that govern the valuation process are “very fractured,” says John Hayes, managing director for Anchor Planning & Valuations and president of the Business Valuation Association.

Existing valuation standards have sprung up as needed for purposes other than financial reporting, such as taxes, litigation, or shareholder disputes, he says. Those general principles can be useful for financial reporting as well, but “all those procedures and methodologies are covered in different standards,” he explains.

In the pecking order of U.S. Generally Accepted Accounting Principles, FASB pronouncements hold the greatest authority. Beyond FASB pronouncements, a host of professional groups offer a variety of valuation standards. Most notable are the Uniform Standards of Professional Appraisal Practice established by the Appraisal Foundation, Hayes says.

But those standards are not universally accepted in the profession, Hayes cautions, and they are not observed by the National Association of Certified Valuation Analysts or the American Institute of Certified Public Accountants. The AICPA, in fact, recently published its own standard on valuation services.

Given FASB’s authority over the subject, Financial Accounting Standard No. 157, *Fair Value Measurements*, will offer some uniformity of approach as it takes effect later this year. That will be especially welcome for illiquid financial assets, says Michael Crain, chair of the Business Valuation Committee of the AICPA. Valuing assets for which there’s no market to provide a benchmark is complicated and steeped in judgment, he says.

“We’re at a point of transition where there’s a desire to see more fair value measurements in financial reporting, but we’re struggling with the complex nature of it,” Crain says. “We need to codify it to make it practical and we need to get accountants and auditors trained in those areas. It may be some time before all this plays out and we reach a final point of having clarity.”

Steven King, of law firm Ballard Spahr Andrews & Ingersoll, says clarity may come in the meantime not only with

the implementation of FAS 157, but with enforcement orders from the Securities and Exchange Commission. For example, the SEC recently issued a cease-and-desist order against Allied Capital Corp. for inadequate valuation of its portfolio securities because Allied employed no third party to assist with or review the process.

“The cease-and-desist order in the Allied case may be the beginning of a chain of either decisions or guidance that may try to unify practices, or at least identify best practices,” King says.

Meanwhile, Bowerman says a dearth of rules, or even guidance, around how to conduct a valuation to meet growing requirements for fair value in financial reporting leaves much open to interpretation. “There’s a pretty big gap right now between what a standard, plain vanilla valuation expert is trained to do and what FASB is expecting these experts to do, and the referee in bridging that gap is the auditors,” he says.

Enter the Auditors



Watts

Gregory Watts, also of the CBIZ Valuation Group, complains of inconsistency in how auditors review valuations and what they require to sign off on the financial statements: “We don’t see consistency by the firm on anything.” Even different regional offices within an audit firm might have different requirements, Watts contends. “We could find within a firm that the San Francisco office focuses on one thing, but the New York office doesn’t care about that, and they want something else.”

Bowerman and Watts say audit inspections conducted by the Public Company Accounting Oversight Board influence the valuation process as well. “It depends on who the PCAOB smacked this month,” Watts says.

Deloitte & Touche, for example, took a punch in its most recent inspection report for not requiring enough background and documentation to support fair value determinations. “So now Deloitte wants more background in the report that’s meaningless,” Watts argues. “It doesn’t impact the conclusion but it adds to the costs, so the process is not furthered any.”

FASB plans to assemble a resource group to offer direction on what kind of guidance the market needs to establish a consistent approach to valuation, but so far it’s getting conflicting advice on the kind of guidance that might help and even who should author it. The Appraisal Foundation, for example, says FASB should stick to writing accounting rules and leave valuation standards to the valuation profession.

Conceding that the market could benefit at least from some best practices, the foundation wrote in a comment letter to FASB: “We believe we can, and already are, bringing the necessary valuation expertise into the process of creating valuation guidance for financial reporting.”

Espen Robak, president of Pluris Valuation Advisers, believes it’s unlikely anyone would wrestle authority over valuation standards away from FASB. “I’ve heard a lot in the valuation business that valuation professional groups should be more involved in setting fair value standards,” he says. “It will be important to have them involved in the process, but ultimately the rules of the game will be set by FASB.”

David Sherman, an accounting professor at Northeastern University, says the most disturbing aspect of the movement toward more use of fair value amid the lack of definitive valuation guidance is the latitude it gives management to manage earnings. “If you think about what people hoped for from Sarbanes-Oxley, fair value accounting has provided more room to manage earnings than we’ve ever had before,” he says.

Valuation experts generally contend that while there’s judgment involved in valuation, credentialed valuation specialists should reach conclusions that are fairly close in number. Sherman disagrees. “There are a lot of assumptions that go into those models,” he says. “There’s a great deal of room for judgment, and that gives so much room to manage those numbers.”

Robak says the implementation of FAS 157 should put to rest concerns like Sherman's. "There is less opportunity to game the values if you determine fair value with empirical data and market transaction data," he says. "As people move toward more empirical data and [have] less reliance on models, we're going to see fewer disputes about what the fair value is. True market data has a wonderful way of resolving disputes."