

Valuations in Financial Reporting (VFR) Issues

May 18, 2007

*Cheryl Tjon-Hing
Valuation Specialist
Office of the Chief Accountant*



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OVERALL KEY MESSAGE

QUALITY OF FAIR VALUE MEASUREMENTS

- Concern over the current experience levels of preparers/auditors
- Current valuation infrastructure – lack thereof

***SEC STAFF OBSERVATIONS:
CURRENT EXPERIENCE LEVELS
IN PREPARING AND AUDITING
FAIR VALUE MEASUREMENTS***





Identified U.S. Valuations for Financial Reporting Players

PREPARERS:

- Management
 - Responsible for recorded fair value measures
 - Even if outside assistance is obtained
 - Not required to obtain the assistance of third party specialists
 - Often third party specialists are obtained for intangible asset valuations
- Third Party Specialists
 - Actuaries (liabilities e.g. pensions)
 - Valuation Specialists
 - Includes, other specialty industry groups (e.g. oil and gas)



U.S. Accredited Valuation Specialists

- In the U.S.- 1 non-member organization (TAF) / 4 member accrediting organizations (ASA, NACVA, IBA, AICPA)
- Each organization has their own set of:
 - Valuation and practice standards
 - Accreditation requirements (excl. TAF)
- Recent efforts to harmonize standards failed
- NO organization has issued a comprehensive set of valuations for financial reporting standards
- Many have approached SEC Staff/FASB to become the Valuations for financial reporting standard setter



Identified U.S. Valuations for Financial Reporting Players

REVIEWERS

- Auditors
 - “Front line” auditors
 - In-house valuation specialists

- *Potentially, SEC Staff*
 - Depending upon assessed risks of reviewers, may be area of focus



Valuations for Financial Reporting Purposes are Unique

- Fair Value is a Financial Accounting Concept
 - Defined most recently in 157
 - Certain accounting standards/related guidance impact fair value methodologies / assumptions (depends upon what is being valued)
 - Fair Value conclusions must be in accordance with U.S. GAAP first before any other prescribed valuation standard theory
- Unfortunately, seeing an insufficient understanding of how certain aspects of U.S. GAAP impact fair value measures
 - Relevant accounting guidance is not labeled “fair value implications – please read!”
 - Evolving standards/new guidance



Valuations for Financial Reporting Purposes are Unique

- Quality Fair Value Measurements
 - Competency in valuations AND understanding of relevant accounting literature
 - Educators play a big role in the near future and long-term
- Currently, seeing generally more “silos” of knowledge
 - Preparers should not rely on the auditor to tell them how to “adjust” fair value results to be consistent with U.S. GAAP valuation guidance/definitions
 - Not role of SEC staff to point out inconsistencies of the fair value measurements with relevant guidance to auditors and preparers

SEC STAFF AND VALUATIONS





The SEC Staff and Valuations: Division of Corporate Finance

- Committed to taking valuation issues seriously
- May look for / ask questions to ensure:
 - Valuation is in compliance with GAAP
 - Overall fair value conclusions and related key assumptions make sense based upon facts and circumstances
 - Appropriate valuation methodologies applied
 - There are sufficient disclosures for investors to make their investment decisions
- May seek advice from OCA as deemed necessary



The SEC Staff and Valuations: Office of the Chief Accountant

Registrant Consultations (Pre-filing)

- Valuation consultation comments have included :
 - Appropriate methodologies
 - Valuation factors to consider
 - Relevant financial reporting guidance to consider
 - Review overall reasonability of numbers given facts and circumstances

***SEC STAFF OBSERVATIONS:
VALUATION
INFRASTRUCTURE CONCERNS***





Valuation Infrastructure Concerns

Infrastructure Component	Accounting Profession	Valuation Profession (Status Quo)
<p><i>Valuations in financial reporting guidance/standards</i></p> <p><i>Formal mechanism to resolve differences/emerging practice issues that is applicable to all practitioners</i></p>	<p><i>Single accreditation and set of standards applied to ALL practitioners</i></p> <p><i>EITF (formal)</i></p> <p><i>FSPs</i></p> <p><i>SEC Staff Consultations (informal)</i></p>	<ul style="list-style-type: none"> • <i>U.S. GAAP/IFRS set out some valuation requirements</i> • <i>AICPA Practice Aids</i> • <i>Audit Firm “policies”</i> • <i>Multiple member valuation organizations each with their own valuation standards – not VFR focused</i> • <i>Valuation Theory not addressed by accrediting organizations standards</i> • <i>Many VRF practitioners are not accredited – look to what peers are doing</i>



Valuation Infrastructure Concerns

<i>Infrastructure Component</i>	<i>Accounting Profession</i>	<i>Valuation Profession (Status Quo)</i>
<i>Professional and Practice Standards</i>	<i>Single accreditation and set of standards applied to ALL practitioners</i>	<ul style="list-style-type: none">• <i>Engagement Letters set out scope</i>• <i>Audit standards – not applicable to non-accountants</i>• <i>AICPA Practice Aids</i>• <i>For accredited practitioners, practice standards issued by respective valuation organizations</i>• <i>Many VRF practitioners are not accredited</i><ul style="list-style-type: none">▪ <i>may not be subject to any practice standards</i>



Valuation Infrastructure Concerns

<i>Infrastructure Component</i>	<i>Accounting Profession</i>	<i>Valuation Profession (Status Quo)</i>
<i>Formal Quality Review process applied to all practitioners</i>	<ul style="list-style-type: none"> • <i>PCAOB reviews</i> 	?
<i>Formal Disciplinary Mechanism that is applied equally to all practitioners</i>	<ul style="list-style-type: none"> • <i>PCAOB</i> • <i>State Licensing Boards</i> • <i>SEC</i> 	?
<i>Legal Liability</i>	<ul style="list-style-type: none"> • <i>To all users of financial statements</i> • <i>Expertized</i> 	<ul style="list-style-type: none"> • <i>To client and identified readers only (unless expertized – very rare)</i>



IMPLICATIONS FOR CURRENT VFR ENVIRONMENT



Current VFR Environment

Implications of Status Quo Infrastructure and Experience Levels of Preparers/Auditors:

- Inconsistent application of fair value measures for the same asset (auditors/management/valuation specialists)
 - Different interpretations may be material
 - Valuation specialists comment that auditors' "defacto" standards are inconsistent across firms and within the firm



Current VFR Environment

Implications (cont'd)

- Defacto role of the auditor is very significant
 - Auditors are commenting that they often have to “teach” the valuation specialists/management
 - Fine line: “auditing” or “doing the valuation”
 - As VFR fees start to decline, quality valuation specialists start to get out of certain markets – perpetuates the cycle
 - ◆ “Low” upfront costs might be shifted to higher Audit fees
 - There may be significant tension between the valuation specialist/management and the auditor
 - SAS 73 expectations
 - Management feels they are paying for the valuation 2x



Current VFR Environment

Implications (cont'd)

- Poor quality valuations may go unchecked
 - SAS 73
 - Auditors, with little valuation experience, may use SAS 73 as a basis to rely on management's valuation specialist once qualifications checked
 - Varying levels of due diligence by valuation specialists
 - ◆ "Expectation Gap" as to role of valuation specialist vs. role of auditor
 - SEC staff expected to be the back stop?



Current VFR Environment

Implications (cont'd)

- Combination of:
 - No liability other than to the management that hired them
 - Lack of recognized valuation standards/guidance that must be followed
 - Lack of an enforcement mechanism

May lead to:

- Biased valuations and/or
- Valuation opinion shopping



Way Forward...

- We seem to now be in a “transitional phase”

*KEY PART OF THE SOLUTION IS IMPROVING
THE QUALITY OF THE VALUATIONS AT
PREPARATION*

- FASB Project on Valuation Guidance
- SEC/PCAOB/FASB staff starting to recognize the need for valuation experience on staff
- Education! Education! Education!



***A FEW COMMENTS
ON SFAS 157***



A Few Comments on 157

157 Principles that are similar to Core Valuation Principles

- Market participant view
- Hypothetical transaction in a notional market
- Highest and best use
- Arm's length transaction
- Both buyer and seller have reasonable knowledge of relevant facts
- There is no compulsion to transact by the buyer and seller
- Price is not necessarily Fair Value



Conclusion

Questions and Answers

