

April 15th, 2007



LETTER OF COMMENT NO. 65 A

FINANCIAL ACCOUNTING SERIES

INVITATION TO COMMENT – VALUATION GUIDANCE FOR FINANCIAL REPORTING

FILE REFERENCE NO 1520-100

Financial Accounting Theory – Group No. 3
Omega College
Nassau, Bahamas

Students

Anna Isaacs
Brendamae Lloyd-Smith
Roselyn Miller

Teacher

Maurice S. Butler, CPA, CA

Running Head: GROUP PROJECT

Financial Accounting Theory Group Project

Anna Isaacs

Brendamae Lloyd-Smith

Roselyn Miller

Omega College

Abstract

The purpose of this group paper is to establish whether or not there is a need for valuation guidance specifically for financial reporting as per the Statements of Financial Accounting Concepts. The level of participation of existing appraisal organizations will be analyzed, as well as the Financial Accounting Standards Board's (FASB) valuation guidance and its assistance from resource groups will be detailed. This paper is intended to broaden one's scope on valuation guidance taken from the three mentioned perspectives.

Question 1 - Is there a need for valuation guidance specifically for financial reporting?

Introduction

The fundamental analysis of any discipline is based on theory. During this time, there is no single accepted method of theory for all accounting data. Theory is a coherent set of hypothetical, conceptual and pragmatic principles forming a general frame of reference for a field of study. The classifications and descriptions used must relate to a specific theory in understanding the relationships and the phenomena and variables that exist (Thomas G. Evans, 2003). Therefore, there must be valuation guidance for financial reporting. We, as a group, believe the current valuation guidance is sufficient and would satisfy the designated measurement attribute for financial accounting purposes.

Theory may not tell us what to do, but provides the necessary information to guide us in the correct direction. It removes a lot of unnecessary data from the original facts. There is internal logic and consistency within the theory.

Statements of Financial Accounting Concepts (SFAC) are a series of publications in the Board's Conceptual Framework for financial accounting and theory. Statements in this framework set forth the objectives and fundamentals that are used as the basis for financial accounting and reporting. The objectives identify the goals and purposes associated with financial reporting, where as the fundamentals are underlying concepts of financial accounting (Thomas G. Evans, 2003).

In the current valuation guidance, financial accounting concepts are used as tools in the guidance process. These concepts may be issued in sequence, but are interrelated and designed to be used jointly because they are coherent and consistent standards that prescribe the nature, function and limits of financial accounting and reporting. They serve the public and provide the best possible information. This information assists in the

efficient functioning of capital and other markets and in the allocation of scarce resources.

The establishment of the objectives and the identification of the fundamental concepts may not have directly told us what to do in solving financial accounting and reporting problems, but have led us in a positive direction because the concepts are efficient tools in solving them.

The FASB's Conceptual Framework is the reigning theory for accounting and is sufficiently robust in determining values in designating measurement attributes for today's financial reporting. It was used to introduce ideas and changes in accounting procedures (Thomas G. Evans, 2003).

The main purposes of the FASB's Framework include:

- (1) To establish objectives and concepts in developing standards of financial reporting and accounting to provide guidance for resolving problems
- (2) To enhance the ability of users to access the content and limitations of information provided by financial accounting and reporting

The Conceptual Framework was expected to develop standards that were consistent and these standards were to provide a frame of reference, which is provided. The Project is intended to ask questions such as:

- (1) What are the objectives of accounting?
- (2) What qualities make accounting information useful?
- (3) What are assets, liabilities, equity, revenues, expenses and net income, and how they are measured?

Conclusion

Valuation guidance is important for financial reporting because it gives a clear understanding of the accounting data and is the basis for all underlying information and should be comprehensible for those who have a reasonable understanding of it. Although some say today's valuation is not completely harmonized, it provides an adequate Conceptual Framework and is sufficiently robust to determine a value that would satisfy a designated attribute for financial accounting purposes. The Conceptual Framework enhances the consistency of standards and serves the public by providing structure and direction; therefore there is no need for valuation guidance specially for financial reporting. The SFAC are guides in accounting and reporting standards and provide a foundation and a means of basic reasoning on which to consider all merits.

Question #2 - What level of participation should existing appraisal organizations have in establishing valuation guidance for financial reporting?

During the past few years there have been a significant number of changes in financial reporting rules. The FASB has been the designated organization in the private sector for establishing standards of financial accounting and reporting. To allow appraisal organizations a unique role in establishing valuation guidance is a decision that will affect many and must be carefully guided by the FASB. History has shown that to allow any organization absolute control to make a decision without getting the input of all concerned only lends to inconsistency and confusion. However, to allow the appraisers to serve as advisors to the standard setters can be beneficial and an enrichment to financial reporting standards, for both public and private enterprises.

Our objective here is to show the critical need of appraisal organizations to the standard setters as an advisor. In doing this we would like to show the failures of previous standard setters who did not involve or seek the advice of experts on subject matters. Let's take a look at the Committee on Accounting Procedure (CAP) established in 1936. Initially this organization sought to develop a comprehensive set of accounting principals, a process that was estimated to take approximately five years (Thomas G. Evans, 2003). Needless to say this had to be abandoned. They further went on to issue pronouncements that were not based on any actual research; instead they were largely based on opinions of the members (Thomas G. Evans, 2003). While one must agree that there has been some accomplishment with the CAP standard setting body, there were also concerns. Concerns expressed were, the decision making process was too slow, they did not represent all public accounting firms and preparers, they did not include users in the standard setting process, they were not open to the views of stake holders and finally their decisions were not based on research and theory, the core foundation of any successful standard setter (Thomas G. Evans, 2003).

Eventually CAP was dissolved and was replaced by a new standard setting body, the Accounting Principals Board (APB) and the Accounting Research Division (ARD). The ARD sponsored research and issued Accounting Research Studies (ARS). They were the ones responsible for bringing to light any new matters to the APB for consideration before the issuance of an Opinion. The group issued principals in the ARS#3, which covered basic accounting topics of interest, but there arose a major controversy. One of the major issues was regarding the “recommended recognition of all objectively determined changes in assets, including the recognition of price-level changes” (Thomas G. Evans 2003, p. 56). There were also concerns on matters relating to the changes in replacement value (Thomas G. Evans, 2003). These subjects one would have thought would be discussed with the experts before a final decision was made. But because the APB neglected to seek advice, the accounting profession rejected these principles.

A decision on valuation guidance should represent all users and stakeholders. Appraisers, because of their experience in working on a day-to-day basis with establishing market value and determining the fair value of assets and liabilities are the ones qualified to provide valuation guidance. These individuals can provide a much clearer and better understanding of issues arising related to the subject matter.

In conclusion, we are of the opinion that the appraisers, who are the practitioners and experts of the subject matter, should be allowed to share their knowledge. They should be allowed to give the standard setters’ guidance, but not conclusive guidance on facets pertaining to valuation. Their input should be carefully considered in an open, thorough and objective manner that will best serve the interest of all. In doing this, it can only lead to improving the credibility of financial reports.

Question 3 - What process should be used for issuing valuation guidance for financial reporting?

The FASB is the standard setter of financial accounting. The potential process that could be used to issue valuation guidance includes the assistance from resource groups for specific issues. Specific resource groups will be able to assist the FASB with distinguishing information, which is more useful from that which is less useful. The two qualities that make information useful are relevance and reliability. If either of those qualities become absent, the resulting financial reports will not be useful. Once information lacks the ability to make a difference in user decisions, it is irrelevant and therefore useless. Also, if the information is not reliable, it cannot be trusted or relied upon.

There are others who will have different opinions on the importance of each of the two primary qualities in different circumstances. The overriding concern however, should be to provide the most useful information for decision making. This is where specific resource groups can make a difference in specific issues. In order to be relevant, information must have either predictive ability or feedback value, and it must be communicated in a timely manner. To be reliable, information must be represented as faithful, verifiable and neutral. These characteristics help assure that the information in the financial reports can be relied upon for decision making purposes.⁽¹⁾

The success of FASB with the assistance of the Emerging Issues Task Force (EITF) can serve as an example to the efficiency of resource groups. Therefore, with specific resource groups to concentrate on specific issues, they would become more effective and efficient than the EITF. The EITF was formed in response to two conflicting tensions in the accounting profession. The Certified Public Accountants (CPA) were faced with issues they believed were not adequately addressed in accounting pronouncements. The

other issue was that the growing body of professional pronouncements had created an accounting standard overload.^{(1) (2)}

The FASB established the EITF in part to meet accountant's needs for timely guidance on accounting practices, methods, and to limit the number of issues whose resolution requires formal pronouncements by the FASB. In many cases the EITF members were able to reach a consensus on how existing pronouncements apply, and therefore offer timely guidance on new types of transactions and circumstances. Thereby, eliminating the need for new FASB statements, interpretation, or staff technical bulletins.^{(1) (2)}

There are other groups that impact accounting standards and are important to the practice of accounting. With the assistance of the other groups, the FASB was able to achieve reasonable independence and not become excessively willing to obey the Securities Exchange Commission, the business community, or the accounting profession. The other groups included accounting professions, academic accountants and statement preparers.⁽³⁾

The American Accounting Association (AAA) is an organization primarily for accounting professors. The role of the AAA in establishing accounting standards includes research projects to assist the FASB and a forum for representing different points of views on various issues. The American Institute of Certified Public Accountants (AICPA) is the professional organization of practicing CPAs in the United States. The AICPA helps the FASB identify emerging issues and communicates the concerns of the CPAs on accounting issues to the FASB. The AICPA often assist the FASB with difficult accounting issues of general interest.⁽³⁾

Providing that different resource groups can be formed for specific issues, the due process of the FASB will be more timely, reliable, relevant and verifiable. Timeliness is important for information to become available before the decision is made, in order for it

to make a difference. Information coming from specific groups on specific issues will be reliable and free from errors. The other resource groups will also be able to supply relevant feedbacks and predictions. Due to the fact that the resource groups will be working on specific issues means that they will be using the same measurement to make the information verifiable.

References

Evans, T. (2003). *Accounting Theory: Contemporary Accounting Issues*. USA: Thomson South-Western.

⁽¹⁾ Skousen, K. F., Stice, E. K., Stice, J. (1998). *Intermediate Accounting*.

⁽²⁾ Financial Accounting Standards Board. Emerging Issues Task Force.
http://www.fasb.org/eitf/about_eitf.shtml

⁽³⁾ Petravick, S., Smith, M. (January 2001). CPA journal.