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LETTER OF COMMENT NO. 65

**FINANCIAL ACCOUNTING SERIES**

**INVITATION TO COMMENT – VALUATION GUIDANCE FOR FINANCIAL REPORTING**

**FILE REFERENCE NO 1520-100**

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On behalf of the Financial Accounting Theory class, group no. 2, of Omega College, we are commenting on the Financial Accounting Series topic, “Valuation Guidance for Financial Reporting”. Our group believes that there is a need for valuation guidance.

This paper provides support for that position. First we look at the need for valuation guidance for financial reporting, followed by what level of participation appraisal organizations should have in establishing valuation guidance and finally we examine the process for issuing valuation guidance.

Sincerely,

Tamaisha Fox  
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Moniqua Farquharson

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

Yes there is a need for valuation guidance specifically for financial reporting, because if there were no guidelines there would be a level of uncertainty in terms of what information would be provided or how the readers of the financial statements may interpret them.

By refining our current valuation assessment process with guidelines and rules for financial reporting, we are able to implement a valuation system, which will enhance reporting accuracy and provide the needed transparency of reports to investors. We believe the set of guidelines described provides a solid foundation for applying consistent, valuation metrics for all companies. The implementation of these refinements will serve to provide credible and accurate information to investors.

If valuation guidance were to be implemented for financial reporting, Statement of Financial Accounting Concepts (SFAC) No. 1: Objectives of Financial Reporting by Business Enterprises, would be enhanced.

The Objectives state:

*“Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions” (Financial Accounting Standards Board 1978, p. 5).*

*“Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others*

*assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise” (Financial Accounting Standards Board 1978, p. 5).*

*“Financial reporting should provide information about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of transactions, events, and circumstances that change its resources and claims to those resources” (Financial Accounting Standards Board 1978, p. 5).*

*“Financial reporting is expected to provide information about an enterprise's financial performance during a period and about how management of an enterprise has discharged its stewardship responsibility to owners” (Financial Accounting Standards Board 1978, p. 5).*

*“Financial accounting is not designed to measure directly the value of a business enterprise, but the information it provides may be helpful to those who wish to estimate its value” (Financial Accounting Standards Board 1978, p. 6).*

*“Management knows more about the enterprise and its affairs than investors, creditors, or other "outsiders" and accordingly can often increase the usefulness of financial information by identifying certain events and circumstances and explaining their financial effects on the enterprise” (Financial Accounting Standards Board 1978, p. 6).*

The aforementioned Objectives will be enhanced through valuation guidance.

The Financial Accounting Standards Board's (FASB) SFAC no. 2 discusses the Qualitative Characteristics of Accounting Information. The need for valuation guidance can impact this concept in the following manner.

Accounting information is useful for decision-making. Subject to constraints imposed by cost and materiality, increased relevance and increased reliability are the characteristics that make information a more desirable commodity - that is, one useful in making decisions (Thomas, G. Evans, 2003).

To be relevant, information must be timely and it must have predictive value or feedback value or both. To be reliable, information must have representational faithfulness and it must be verifiable and neutral.

Comparability, which includes consistency, is a secondary quality that interacts with relevance and reliability to contribute to the usefulness of information

Therefore through valuation guidance information will be thought to be more relevant and reliable.

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

The FASB as a governing body from its beginning to now have set the standards for accountability. Financial reporting is not an end to it self, but is intended to provide information that is useful in making business and economic decisions.

Appraisal organizations should have a full level of participation in establishing valuation guidance for financial reporting. Appraisal organizations are already used for a variety of purposes *in financial reporting, including purchase price allocation relating to Statement of Financial Accounting Standards (SFAS) No. 141*. According to SFAS No. 141, land, natural resources and non-marketable securities can be appraised for assigning amounts to assets acquired (Financial Accounting Standards Board 2001). In regards to allocating the cost of an acquired entity to assets acquired and liabilities assumed, “among other sources of relevant information, independent appraisals and actuarial or other valuations may be

used as an aid in determining the estimated fair values of assets acquired and liabilities assumed” (Financial Accounting Standards Board 2001 p. 15).

Therefore the FASB already has an established relationship with appraisal organizations according to SFAS no. 141.

***Question: 3 – What Process Should Be Used for Issuing Valuation Guidance for Financial Reporting?***

The FASB could issue valuation guidance with the assistance from resource groups for specific issues.

“The mission of FASB is to establish and improve standards of the financial accounting and reporting for guidance of the public, including users, auditors and users of financial information” (Thomas, G. Evans, 2003 p.93).

Since the formation of the FASB in the 1970's it has included all external users of accounting information in its process. To answer the question, we think the FASB, could issue valuation guidance with the assistance from groups for specific issues. The FASB is well equipped to issue valuation guidance with the assistance from other groups, since the FASB has been a success since its inception. They did not make the same mistake as past organizations by not including external users. The FASB allows interested parties to make an input. They treat all opinions equal and they are open; nothing is done in secret. The FASB's success is due based on the fact that they hold public hearings which gives the public a chance to ask their questions and receive answers; the public is also able to submit their input in writing. The FASB's openness gives interested parties (preparers, public accountants, analyst, appraisal organizations, etc.) many opportunities to provide input. Therefore preparers and users have unprecedented opportunities to influence the standard setting process.

Since 1973, the FASB has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation of financial reports and are officially recognized as authoritative by the Securities and Exchange Commission and the American Institute of Certified Public Accountants. Such standards are essential to the efficient functioning of the economy because investors, creditors, auditors and others rely on credible, transparent and comparable financial information. Therefore the FASB began its operations with a solid foundation in terms of authority and organizational structure.

In 1973 the FASB launched the Conceptual Framework Project which was used to help them establish objectives and concepts for developing standards, provide guidance for resolving problems and to enhance the ability of users. Under the FASB's Conceptual Framework Project, a series of seven (7) SFAC were established; this was the first time in the history of accounting that there was a generally agreed theory of accounting. The FASB to date has even issued over 150 SFAS, and is still seeking ways to improve. Therefore based on the FASB's historical success and infrastructure we recommend them to issue valuation guidance with the assistance from resource groups for specific groups.

## References

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

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