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April 10, 2007

Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, Connecticut 06856-5116



LETTER OF COMMENT NO. 2/

Re: File Reference No. 1520-100, "Invitation to Comment on Valuation Guidance for Financial Reporting"

Analytical Value LLC is pleased to have this opportunity to respond to the Financial Accounting Standards Board's request for comments on "Valuation Guidance for Financial Reporting".

Analytical Value is a consulting firm that addresses complex financial and business management issues through the application of analytical tools and techniques, and much of our work deals with business valuation and measurement challenges in a variety of contexts, including litigation and dispute resolution, organizational transition, and restructuring. Our principals are Certified Public Accountants with decades of experience in public and private accounting, and hold additional certifications from a number of professional organizations, including business valuation-specific credentials. We believe business valuation professionals are at times producers of financial information as well as users of financial statements, and the consequences of this dual role should be noted in the consideration of valuation guidance in financial reporting.

We have seen the business valuation specialization develop from a largely unrestrained arena with limited guidance or direction to the current environment where numerous competing organizations provide professional valuation certifications and designations, establish standards of professional practice for their members, and from time to time cooperate with other organizations on the establishment of broader guidelines. Our comments are intended to provide whatever benefit may be obtained from our perspective and experience.

Question 1 – Is There a Need for Valuation Guidance Specifically for Financial Reporting? Yes, in our current environment several aspects of financial reporting directly affect business valuation, and business valuation inputs can have a material effect on the financial statements. The FASB offers specific business valuation guidance for financial reporting already in FAS 141, 142, and 157, as well as the reconsiderations of FAS 141 and 142. This is in addition to the guidance provided in the Conceptual Framework projects that should provide a conceptual underpinning relevant to the business valuation questions "What are we valuing? How is it measured? What adjustments, if any, are required to the reported financial statements to

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accomplish the objectives of our business valuation?" The discussion in Statement of Financial Accounting Concepts No. 2, "Qualitative Characteristics of Accounting Information" regarding relevance and reliability is directly applicable to business valuation. To be relevant to a business valuation, information must be timely and it must have predictive value. To be reliable, information must have representational faithfulness and it must be verifiable and neutral.

The Financial Accounting Standards Board is already in the business of providing guidance that affects business valuation. The Statements that have been published (and reconsidered) are indications that there are needs perceived by the constituents of the FASB for such guidance. Unless the FASB is ready to yield part of its responsibility for GAAP standards-setting to other bodies or to abdicate portions of those responsibilities to the uncontrolled marketplace, the Board will continue to be involved in the guidance process. The more relevant questions are "Should the FASB consider the business valuation implications of its pronouncements separately from or in addition to other accounting and financial reporting implications?" and, if so, "What structure would permit the FASB to accommodate valuation information and inputs most effectively in a system governed by due process obligations and requirements for transparency?" We believe there are times when valuation implications merit separate consideration as part of the process. We also believe that changes to the FASB structure should be considered in terms of the benefits to be obtained from the proposed change and the costs necessary to accomplish such change.

Valuation guidance can overlap existing FASB initiatives. For example, the ongoing consideration of whether financial reporting standards should differ between large companies and small ones may have a bearing on whether mandated disclosures of cost of capital information apply to all companies or only the largest publicly-held companies. An appraiser may be very interested in obtaining such information on a small company but that interest may be outweighed by the costs imposed on the small company to collect, validate, and publish it.

We do not suggest that the FASB accept responsibility for establishing the standards of professional practice in business valuation. Those standards should be established by the appropriate voluntary bodies and validated by the marketplace. We are suggesting that the FASB establish a mechanism to identify and consider valuation implications of its financial reporting pronouncements as an additional input to deliberative due process.

Question 1(a) – Should Valuation Guidance Include Conceptual Valuation Guidance, Detailed Implementation Guidance, or a Combination of Both?

As the discussions in the professional literature over the past several years should indicate, there are many strong arguments favoring "principles-based accounting regulation" over "rules-based accounting regulation". It appears that the FASB and other standards-setting bodies have set out on the path to principles-based standards, and we can think of no valuation-specific arguments that would contradict that direction. Accordingly, any valuation guidance considered by the FASB should relate back to the underlying concepts governing the items or events under

¹ Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 2: Qualitative Characteristics of Accounting Information, May 1980, p. 5

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consideration. This should be consistent with the ongoing efforts to address the conceptual framework for financial reporting.

Having said that, there are numerous examples throughout the accounting literature and history of accounting where how to apply the fundamental concepts was not readily apparent, and where detailed implementation guidance would have helped to reduce diversity in practice. In fact, that is part of the job description of the Emerging Issues Task Force. Quoting from the FASB web site,

The EITF was designed to promulgate implementation guidance within the framework of existing authoritative literature to reduce diversity in practice on a timely basis. The EITF was designed to minimize the need for the FASB to spend time and effort addressing narrow implementation, application, or other emerging issues that can be analyzed within existing GAAP².

The EITF may not have the necessary scope, background or support to address valuation issues but it is cited as an analogy to illustrate that similar needs have been recognized in the past. Questions concerning implementation will always arise, and the guidance process should recognize this ongoing requirement. We agree with the comments of the Construction Financial Management Association that "It is impossible to address every specific valuation situation, and any attempt to do so would create overly complex, and possibly confusing, guidance. However, detailed guidance would benefit businesses in certain situations." Combining conceptual guidance with the level of detailed guidance called for by a particular situation seems to make the most sense to us.

Question 1(b) - What Should Be the Duration of Any Valuation-Guidance-Setting Activities?

Valuation-guidance-setting activities should conclude when all the valuation guidance issues have been resolved or when the need for valuation has gone away. In other words, the duration of the guidance process should be permanent. Any attempt to set a deadline for resolution of the issues would only mean that a new crop of issues would spring up as soon as the deadline is reached.

Question 2 - What Level of Participation Should Existing Appraisal Organizations Have in Establishing Valuation Guidance for Financial Reporting?

Existing appraisal organizations have invested countless hours in discussion, deliberation, negotiation, and revision to their valuation standards and professional guidance. Over the years, marketplace changes and implementation issues have been considered and reflected in valuation standards of individual organizations and collaborations between organizations. There is a widely accepted "International Glossary of Business Valuation Terms" that has been endorsed by

² Financial Accounting Standards Board, "Emerging Issues Task Force General Information", http://fasb.org/eitf/about_eitf.shtml, visited April 4, 2007

³ Construction Financial Management Association, "March 28, 2007 letter to Financial Accounting Standards Board re: File Reference No. 1520-100", Letter of Comment No. 10

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the American Institute of Certified Public Accountants, the American Society of Appraisers, the Canadian Institute of Chartered Business Valuators, the National Association of Certified Valuation Analysts, and the Institute of Business Appraisers.

However, there is no single appraisal organization or coalition of organizations that is the preeminent source of guidance for all business appraisers. For every time the Tax Court suggests that the appraiser should justify departures from the Uniform Standards of Professional Appraisal Practice, there seems to be a statement from a professional organization that "USPAP is helpful, but our members are not bound to follow USPAP in reaching their professional opinion of value." Valid business considerations and differences in constituencies between organizations are real and are not likely to go away in the near future. Selecting a single appraisal organization to establish standards for valuation guidance in financial reporting would place the FASB in the position of "picking a winner" among the rival organizations and cause needless dissension among the organizations that were not chosen. Business valuation specialists who are accountants by training will perhaps be the most natural constituency for the FASB to consider, for those "appraiser/accountants" are likely to demonstrate an interest in how financial statements are created and validated, in addition to being interested in how the financial statement information can be used in their role as appraiser.

We believe that the existing appraisal organizations have valuable insights and perspectives to offer, and may provide an efficient mechanism to collect input from their membership if they choose to operate as a representative organization. There should be some way to facilitate the sharing of those insights and perspectives with the FASB. Having said that, we do not believe that the existing appraisal organizations are the only possible source of valid insights and perspectives on valuation issues. There are numerous leaders in the appraisal profession who continue to make substantive contributions to the common body of knowledge without serving as a representative of any appraisal organization. To the extent that the appraisal organizations feel it necessary to "protect their turf", non-aligned individuals may in fact provide a less-biased source of insights and perspectives. Appraisers who are not accountants may have valid comments to offer from the end-user viewpoint, and those observations should be encouraged. However, the financial reporting guidance issued by the FASB is most likely to have a direct impact on preparers of financial statements, traditionally the domain of the accountant.

Looking around the existing FASB structure, the Investor Task Force would seem to be analogous to a body composed only of representatives from the established appraisal organizations. The Small Business Advisory Council and the User Advisory Council appear to provide models for broad-based participation reflecting insights from a variety of constituencies. Philosophically, we tend to favor broad-based participation, but the FASB is in a better position to evaluate the productivity of the two different models for participation and the benefits gained from each one. We note that one of the functions defined for the EITF is to attempt to reach consensus, or by its failure to reach consensus the EITF will alert the FASB that there is real divergence in practice that may need to be addressed. It remains to be seen whether any participative model for obtaining valuation perspectives will be able to consistently reach consensus, so we suggest deferring the establishment of such a required function for the valuation advisory group until there is a history to evaluate.

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We would support the creation of a new advisory council reflecting the various perspectives of the valuation community if it is agreed that the scope of work for such a body falls outside the spheres of responsibility and competence of the existing FASB advisory bodies. We do not agree that possession of specific appraisal certifications or other professional designations should be a requirement for participation in the advisory council. Rather, the council should be made up of professionals and users of financial information who have the experience and qualifications to provide meaningful insights into the issues likely to be under study by the advisory council.

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

Don't reinvent the wheel. If there is a process in place that adequately accumulates constituent information and addresses financial reporting issues as they arise, adapt that process to the valuation community. It is clear that the particular interests and concerns of the valuation community are the top priority of the appraisal organizations, so in balancing the requirements of the FASB to consider the needs of all constituencies it should be apparent that the appraisal organizations should have input into the process but not control of it.

The FASB has years of experience in deliberative due process, and has had many opportunities to learn how to solicit and accumulate public input, analyze that input in the context of financial reporting standards, and assimilate the input into the establishment or clarification of standards. The existing guidance mechanisms available to the FASB and the authoritative qualities of the guidance they provide have been recognized in the hierarchy of Generally Accepted Accounting Principles, another existing FASB project. Creating a completely new process now could be interpreted as an indication by the FASB that its existing processes do not provide a satisfactory model that could be applied to issuing valuation guidance for financial reporting.

We suggest that the FASB select a staff person with appropriate knowledge and background to serve as the focal point for communications with the new Advisory Council and with the appraisal community. Knowing the players and some of the history would help keep the communication lines open, but if there is no one currently on staff with that kind of history we are sure that the designated contact person will have ample opportunity to learn from the large volume of input we expect the appraisal community to provide.

Question 4 – Should the Process of Valuation Guidance Be on an International or National Level?

The answer to this question should be the same as the answer to the question "Should Generally Accepted Accounting Principles be determined on an International or National Level?" Harmonization of accounting principles throughout the world is a noble goal, and the FASB is already participating in efforts towards that harmonization. But the process is necessarily a long one, and there may be urgent issues that need to be addressed before national and international standards are completely in tune. We suggest that the FASB recognize that there are likely to be international implications and considerations for its valuation guidance and accept international input as available, but do not hold up the process waiting for elusive international consensus.

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In an ideal world, the international and national standards would be the same. In the real world, the needs for current guidance on valuation issues in financial reporting will outweigh the theoretical benefits of waiting for all the world's constraints to be considered and resolved in harmonious standards applicable to everyone and everything. The process can be designed to facilitate international input by reaching out to appraisal organizations and practitioners in different countries, but ultimately the FASB only sets standards for the United States (which indirectly may affect the rest of the world).

Other Potential Issues

- a. Who should grant authority to issue the valuation guidance?
- b. What due process procedures should the standard setter follow in issuing valuation guidance?
- c. How should any other organization that issues valuation guidance be funded?

We believe these questions are moot, since we strongly suggest that the FASB retain responsibility for issuing valuation guidance in financial reporting.

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Thank you for this opportunity to comment. Please contact me if you have any questions or need additional information.

Very truly yours,

/s/ William H. Black

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