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INVESTMENT BANKING SERVICES

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E-Mail Submission



LETTER OF COMMENT NO. 42

Technical Director
director@fasb.org
File Reference No. 1520-100

Dear Technical Director:

We are pleased to submit our responses with respect to the Invitation to Comment: Valuation Guidance; File Reference No. 1520-100.

Our firm has significant experience in providing valuation advisory services to both public and private companies of all sizes in connection with purchase price allocations for financial reporting purposes. Our comments have been prepared by valuation practitioners and professionals in our firm who serve on our Technical Guidelines Committee for our Tax and Financial Reporting Valuation Services Practice Area.

As described in more detail herein, we believe the issuance of valuation guidance can serve a critical need in measuring and reporting of fair values.

If you would like to discuss any of our comments or solicit any additional feedback from us, please contact either of us at the numbers below.

Sincerely,

Houlihan Lokey Howard & Zukin

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NEED FOR VALUATION GUIDANCE

Question 1—Is There a Need for Valuation Guidance Specifically for Financial Reporting?

Yes.

The key term in Question 1 is “guidance.” As the provision of a valuation opinion relies on subjective reasoning and professional judgment as much as quantitative analysis and calculations, the task is ill suited for specific rules and bright-line boundaries. However, making additional guidance available to valuation specialists is consistent with the application of principles-based accounting. The guidance should relate to “traditional” appraisal concepts, methods and procedures applied to the financial reporting framework. While differences of opinion will likely always exist in the valuation profession, for financial reporting such differences of opinion should be driven by the valuation specialist’s assessment of the facts and circumstances of a specific situation (i.e., company, security, asset, liability, etc.) and not by interpretations of GAAP and related literature (i.e., AICPA Practice Aids).

In addition to enhancing the quality of the fair value estimates and improving the “auditability” of such figures, having valuation guidance should also improve the cost and time efficiency of the audit process. The efficiencies will be particularly evident with respect to the review procedures conducted by audit teams pursuant to SAS No. 73, *Using the Work of a Specialist*. Many valuation specialists (including this firm) have observed divergence in practice with respect to such review procedures. The divergent practices exist not only among different audit firms, but also among different offices within the same audit firm and among different valuation reviewers within the same office of the audit firm. While review procedures will continue to serve an important function in developing fair value estimates, having valuation guidance available to the specialist should substantially improve many aspects of the review process.

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

The valuation guidance would be most effective by combining conceptual valuation guidance along with detailed implementation guidance. Following are examples of each.

Conceptual valuation guidance can be provided for the following topics:

- Hierarchy of preferable valuation approaches: income, market and cost
- Hierarchy of preferable valuation methods under the income approach: relief from royalty, excess earnings, with and without, greenfield
- Application of the cost approach on a pretax or after-tax basis
- Valuation of acquired intangible assets that may be utilized by market participants, but abandoned by the specific acquirer

Detailed implementation guidance can be provided for the following topics:

- Valuation of reporting units on a control or minority interest basis for purposes of goodwill impairment testing under SFAS 142
- Definition of “cash flow” for purposes of long-lived asset impairment testing under SFAS 144
- Application of contributory asset charges when valuing intangible assets under SFAS 141 and 144
- Acceptable methods for quantifying discounts for lack of marketability in common stock valuations

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

The valuation guidance should be formally revisited once every five years. Periodic updates can be issued on an as needed basis.

LEVEL OF PARTICIPATION BY EXISTING APPRAISAL ORGANIZATIONS

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

As discussed in more detail below, *members* from the existing appraisal organizations should have a meaningful level of participation in establishing valuation guidance. However, the appraisals organizations need not participate as an *official association*.

PROCESS FOR ISSUING VALUATION GUIDANCE

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

The process used for issuing valuation guidance should be similar to that used by the American Institute of Certified Public Accountants (AICPA) in the issuance of its Practice Aids: Assets Acquired in a Business Combination to Be Used in Research and Development Activities: A Focus on Software, Electronic Devices, and Pharmaceutical Industries and Valuation of Privately-Held-Company Securities Issued as Compensation. That is, valuation guidance should be developed by a task force comprised of representatives from the appraisal, financial analyst, preparer and public accounting communities. While the publication on such valuation guidance will not be ratified by the FASB, members of FASB and the SEC should serve as “observers” to the task force. The participation of a broad cross-section of representatives will ensure that various viewpoints and perspectives are fully considered in identifying relevant issues and developing appropriate guidance.

The valuation guidance task force should identify the issues, reach a consensus and compose a draft of its report. The report would be issued for public comment with a minimum 30-day comment period. The valuation guidance task force would review comments on the draft report at a future meeting to determine whether to approve the report as currently drafted or make modifications to the draft report and re-issue a modified report for a second (and final) time for public comment with another minimum 30-day comment period. The valuation guidance would be issued in final form after the review of comments received in the second public comment period.

INTERNATIONAL CONVERGENCE

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

While convergence of national and international valuation guidance would be the long-term goal, time constraints and administrative logistics likely require an immediate focus on U.S. GAAP with international application addressed at a later date. While no formal valuation guidance would be developed for international accounting standards, the differences, if any, for international application should be identified as part of establishing valuation guidance for US GAAP.

OTHER POTENTIAL ISSUES

Below is a list of other potential issues that may need to be addressed depending on the level of involvement that the FASB might have in the development of future valuation guidance.

a. Who should grant authority to issue the valuation guidance?

- Under the structure proposed herein, no entity is required to grant authority for the valuation guidance. Similar to the AICPA Practice Aids, the valuation guidance would reflect what the developers believe are best practices. However, the valuation guidance would not be approved, disapproved or otherwise acted upon by any senior technical committee of the FASB or AICPA and, as such, would have no official or authoritative status.

b. What due process procedures should the standard setter follow in issuing valuation guidance?

- As observers to the valuation guidance task force, the FASB should provide input throughout the process. While the guidance would not be ratified by the FASB, any objections should be brought to the attention of the task force by the FASB observers. In the event non-valuation issues are identified by the task force that require specific consideration by the FASB, the FASB can decide at that point in time as to the necessary procedures for reaching resolution.

c. How should any other organization that issues valuation guidance be funded?

- The organization (or task force) responsible for developing and issuing the valuation guidance would be "self-funded." Participating members would be "sponsored" by their respective firms or organizations, and would be responsible for the direct and indirect costs incurred. In addition, the sponsor firms would be required to contribute funds on an annual basis. The specific contribution amount would be determined as part of the development of a more formal agenda for the task force. As each sponsor firm would have a single member appointed to the valuation guidance task force, the annual contributions would be consistent across the participating members.