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INVITATION TO COMMENT – VALUATION GUIDANCE FOR FINANCIAL REPORTING

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Financial Accounting Theory - Group No. 1 Omega College Nassau, Bahamas



LETTER OF COMMENT NO. 45B

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

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

There is a need for valuation guidance for financial reporting. Companies are challenged with the option to measure assets and liabilities at fair value and likely to face more in the future. Valuation guidance should cater to the broad classes from a macro perspective to ensure understandability, decision usefulness, relevance, reliability, comparability and consistency. These characteristics should be the main focus of the valuation guidance for financial reporting. (1)

The International Valuation Standard Committee founded in 1981, which is represented by some 52 countries, showed that there was a pressing need for a set of uniform standards worldwide. This is due to the fact that many countries have their own standards. Although the basic ingredient has already been covered for accounting information there is still a need for guidance, regarding procedures for valuation of assets, liabilities, mortgage lending or tax matters. This approach should be in coordination with other world bodies, which should be fully recognized and adopted by regulators.⁽²⁾

Another reason for valuation guidance as it relates to financial reporting, is the issues that remain unresolved. One issue to be addressed is the development of the union in which external decisions and decision-makers should be the primary focus. This raised the question, as to how should financial reporting provide information to those who make decisions as it relates to investment and credit for smaller private entities or non-profit organizations compared to public sector bodies? Would these bodies need more, less or different financial reporting information, than those making decisions about large, publicly traded companies? ⁽³⁾

It was stated that emphasis on detailed rules instead of broad principles has contributed to delays in issuing timely guidance. Due to the fact that the standards are developed based on rules, and not broad principles, they are not enough to accommodate future developments in the marketplace. Valuation guidance would also help clear up contradictions as it relates to cash flow. The Financial Accounting Standards Board's (FASB) approach in Statement of Financial Accounting Concept (SFAC) no. I justified that the accrual basis would provide users with the three important aspects as it relates to cash flow: the amount, timing and uncertainty of cash flows. "FASB concluded that accrual accounting information such as net income is more informative than current cash flow information for those concerned with the cash flows of the firm." (Thomas G. Evans 2003, p. 48). However there are still those that believe that there should be a return to the cash basis of accounting. Hence valuation will help to justify why accrual accounting serves the user's need for cash information than actual cash information itself (Thomas G. Evans, 2003).

Another reason that would prove necessary for valuation guidance, is the question of what will users of accounting information base their decision on as it relates to the qualitative characteristics as outlined in SFAC no. 2.

According to the FASB, quality makes information an attractive commodity for decision-making. However, what would be determined as quality? SFAC no. 2 focuses on two primary qualities. Relevance which is defined as making a difference in a decision and reliability, which is defined as free from error and the assurance that the measure is represented authentically. Relevance is further subdivided into three ingredients: predictive value, feedback value and timeliness. Reliability is also divided into three ingredients: verifiability, neutrality and representational accuracy. Valuation guidance would help enhance these characteristics of financial reporting. (Thomas G. Evans, 2003).

Valuation Guidance is also needed as it relates to comprehensive income.

In SFAC #6, the ten elements of financial statements shows that the FASB adopted the asset-liability approach for its definition of income. SFAC #6 represented a major switch form matching to the asset-liability approach and from the income statement to the balance sheet as the primary financial statement. Comprehensive income was the most controversial aspect of the FASB's definitions of the ten elements when it first appeared in 1980. Based on this the FASB was encouraged by many, including the Association for Investment Management and Research (AIMR), to develop a standard that required the disclosure of comprehensive income. Although prior to the development of the Comprehensive Income Statement, such market value changes were reported in an unorganized way. Now the new statement is more organized. However, valuation guidance is necessary because the asset-liability approach and comprehensive income reporting has provided flexibility, that could produce a lack of comparability, which could create confusion on the part of the statement users and reduce the impact and importance of comprehensive income. (Thomas G. Evans, 2003).

The FASB has been a success to-date. Although the FASB standards are still presently being used, there are still questions regarding some information as it relates to the SFAC. This is why there should be other organizations that should provide assistance with valuation guidance. This should help clear up any concerns that other bodies may have. This would ensure that information provided is un-biased and can be viewed as information provided for a more global perspective.

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

Based on the failures of the Committee on Accounting Principles (CAP) and the Accounting Principles Board (APB) to involve experts during their tenures and based on the success of the FASB to have all interested parties involved, existing appraisal organizations should play an important role in the establishment of valuation guidance for financial reporting.

CAP produced fifty-one pronouncements, which are called Accounting Research Bulletins (ARB). The Bulletins were considered standards by the Securities Exchange Commission and ARBs are a part of the present day Generally Accepted Accounting Principles. CAP was not open to all public firms and prepares, users were not included in the standard setting process of accounting, and stakeholder's input was also not accepted.

The Accounting Principles Board (APB) was formed in 1959. The APB did not use due process or open deliberations to gather feedback or insight on proposed accounting standards. The APB waited until later in its tenure to get such feedback. The APB lacked getting feed back from the general public along with open deliberations that would have helped in obtaining answers to question that were left unanswered for proposed standards.

The FASB was able to provide a new view on accounting, which played a major role in the economy and financial information setting. The factor to the FASB's success is that different views are represented on the Board. The FASB helped in educating the public and worked on solving problems, which consist of feedback, written and oral, surveys and research

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.

So far the FASB's due process has been a successful one. One of the reasons mistakes were made by the past accounting organizations has been because they did not establish opening public hearings. The FASB's development of its Conceptual Framework (CF) Project, which is currently the reigning theory for accounting, is an example of the success of the FASB involving all interested parties.

Assistance from separate resource groups gives the FASB an informative outlook on the evolving patterns within assets and liabilities. For instance, a resource group could prove to be conducive towards dealing with special cases.

For the most part, many firms have developed special units to provide formal input to the FASB. The units of these firms monitor the FASB and issues that are in consideration by the FASB. Another responsibility of these units is to consider each exposure draft and how they would directly affect their firm (Thomas G. Evans, 2003).

So one can see therefore the usefulness of resource groups within firms. These various firms have been given an opportunity to serve on the FASB'S task force, and this has proven to be very effective in the FASB's due process mechanism. Information provided by resource groups can influence accounting standards (Thomas G. Evans, 2003).

References

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