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PUBLIC COMPANY ADVISER

Helping Public Companies

From assisting you with your IPO to compliance with SEC and Sarbanes-Oxley regulations, Holtz Rubenstein Reminick has been helping middle market companies succeed. We are one of the leading CPA firms in the country serving SEC registrants.

Is Fair Value Fair?

Fair Value Measurements

Few pronouncements by the Financial Accounting Standards Board (FASB) have been as controversial as Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). FASB issued SFAS 157 in September 2006. SFAS 157 became effective for fiscal years beginning after November 15, 2007, which, for calendar year companies, became effective for 2008.

Some critics have blamed SFAS 157, at least in part, for the country's current financial crisis. Supporters, on the other hand, argue that fair value accounting is merely a reflection of the underlying problem.

Harmful or beneficial, fair value appears to be here to stay. As of this writing, the SEC has resisted calls (by the American Bankers Association and others) to suspend fair value accounting until the financial markets recover. In an effort to ease concerns, however, FASB has issued guidance on the standard's application in situations involving inactive markets.

Three-tier value hierarchy

SFAS 157 defines fair value as *"the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."* Here, an "orderly" transaction is one that isn't compelled, such as a forced liquidation or a distress sale.

To help companies determine fair value, SFAS 157 establishes a three-tier hierarchy that emphasizes market-based valuation techniques. It gives highest priority to Level 1 inputs — quoted prices in active markets for identical assets or liabilities. If these prices aren't available, the standard makes Level 2 inputs, such as quoted prices in active markets for similar assets or liabilities or other "observable" inputs, the next best choice. It gives lowest priority to Level 3's "unobservable" inputs, such as the reporting entity's own data. SFAS 157 emphasizes that, even when relying on Level 3 inputs, the objective remains the same: to arrive at an exit price from a market participant's perspective.

Pros and cons

Critics of SFAS 157 claim that, by focusing on the exit price, the standard requires entities to value assets at "fire-sale" prices, regardless of whether they plan to sell or hold. Further, it presumes that observable inputs, such as market prices, are the most reliable indicators of fair value, while unobservable inputs,

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A View from the Top

Welcome to the first issue of Holtz Rubenstein Reminick's newsletter dedicated to the concerns and activities of publicly-traded companies.

We understand the unique aspects of your business and look forward to providing you with information that will help you remain profitable and in compliance.

Is there something specific you'd like to know? I encourage you to submit ideas for future articles. We want this publication to be as detailed as possible, to meet your needs.

For a hard copy of this newsletter, please contact info@hrrllp.com.

Larry Waldman

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such as the entity's own cash-flow projections, are the least reliable.

As for the financial crisis, detractors contend that SFAS 157 forced financial institutions to value distressed assets much lower than necessary. Lower asset values, they claim, drove such institutions to tighten lending.

But proponents of SFAS 157 disagree, asserting that the standard provides a more accurate picture of an entity's financial condition and greater transparency to investors and other financial statement users. A JPMorgan Chase & Co. analyst, for example, observed that *"blaming fair value accounting for the credit crisis is a lot like going to a doctor for a diagnosis and then blaming him for telling you that you are sick."*

FASB talks back

To quell concerns about fair value, the SEC and FASB issued a joint statement in September 2008. It advised companies to use internal assumptions, such as expected cash flows and appropriately risk-adjusted discount rates, to value securities when relevant market data is unavailable.

Soon thereafter, FASB issued FASB Staff Position (FSP) 157-3 to provide *"guidance on how to determine the fair value of financial assets when the market for that asset is not active."*

FASB emphasized that the guidance isn't new but merely clarifies SFAS 157's principles-based approach.

According to FSP 157-3, an entity *"may determine that observable inputs...require significant adjustment based on unobservable data and thus would be considered a Level 3 fair value measurement."* It also notes that broker or pricing service quotes may be appropriate indicators of fair value, but they *"are not necessarily determinative if an active market does not exist...."* Determining fair value under these circumstances, FASB explains, may require the use of significant judgment about whether individual transactions are forced liquidations or distress sales.

Playing fair

As clarified by FSP 157-3, SFAS 157 indicates that the use of management judgement is necessary and appropriate in evaluating fair value when limited relevant market data exists. If fair value accounting plays a significant role in your financial reporting, you should review your financial statements in light of these new accounting guidelines. h

Save the Date: HRR CFO Roundtable

Holtz Rubenstein Reminick is hosting a roundtable for Chief Financial Officers of middle-market publicly-traded companies. Its purpose is to offer CFOs an open forum to discuss recent SEC rulings, FASB pronouncements, and SOX compliance issues, among other current topics. Please join us:

Thursday, April 23
8:30 to 10:00 a.m.
125 Baylis Road, Melville, NY

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Have a Question? Contact an HRR Partner

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