

Introduction

In October of 2002 the FASB and the IASB entered into a **Memorandum of Understanding** in which both the FASB and IASB pledged to use their best efforts to:

- **Make their existing financial reporting standards fully compatible as soon practicable and**
- **To coordinate their future work programs to ensure that once achieved, compatibility is maintained.**

To achieve compatibility, the FASB and IASB agreed, as a matter of **high priority**, to:

- **Undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and IFRSs;**
- **Remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs;**
- **Continue progress on the joint projects that they are currently undertaking; and,**
- **Encourage their respective interpretative bodies to coordinate their activities.**

FASB has addressed topics which recently had been addressed by IASB, e.g., nonmonetary exchanges, accounting changes and the IASB addressed topics which recently had been addressed by FASB e.g., impairment of assets, restructuring costs.

“The Train has Left the Station”

However, could this be a
One-Way Track?

Developments Continue

On **April 30, 2007**, President Bush and European leaders signed an agreement resolving to promote transatlantic economic integration, including convergence of U.S. GAAP and International Financial Reporting Standards (IFRS).

Also In 2007, the SEC publicly stated it is working toward an arrangement whereby foreign private issuers can elect either U.S. GAAP or IFRS by 2009.

This presentation will explore the issues involved.

Major Considerations

PROs:

- Convergence **may result** in a reversion to a **more principle-based accounting and flexible reporting structure** oriented to a **consumer desired information structure** in lieu of rule-based accounting and prescribed format and content financial statements.

International Accounting and Reporting Standards are more principle-based than the FASB Rule-Based Standards.

Some, however, argue that the difference is merely a matter of scale. IAS has more principles than rules while FASB has more rules than principles.

However, the volume of literature is equal!

- Convergence of financial reporting standards Is important to the efficient and effective **flow of capital in global financial markets.**
- Convergence can **reduce the accounting costs** associated with global financing opportunities.
- **Principles-Based, Consumer-Driven** accounting and reporting **permits professional judgment emphasizing Relevance** rather than **Rule Compliance**
- A principle-based environment can (**MUST, in the DL's view**) lead to **litigation and regulatory reform.**
- Convergences **might reduce measurement and disclosure complexity.**

Major Considerations

PROs:

- Flexible reporting content would permit **timely response to consumer information needs** and **facilitate understanding** by analysts and investors

In this DL's view, at worst,
**the mere dialogue about “principles vs rules” and “flexible reporting content”
is the value to be derived from the journey!**

CONS::

- Convergence could result in **greater Federal involvement** in accounting and reporting standards.
 - T the U.S. Congress historically has taken a “hands-off” approach, recognizing the hazards if politics are injected into the complex mix affecting standard setting. U.S. lawmakers have been resistant to becoming directly involved in the setting of accounting and reporting standards
 - By contrast, the IASB is also subject to more intensive geopolitical pressures than the FASB. For example, in Europe IASB standards are required to be run through the European Union. Approval is not automatic;.

**Consequently,
adopting IFRS may be tantamount to letting the European parliament set our
standards.**

- The European standards development organizations are dominated by the Big 4 and auditees. Financing is principally from those parties.

Does this suggest that a “Big, Tail might WAG a Small Dog”

Put another way,
Should the U.S. Lead or Follow?

CONs:

- **The “trickle-down” effect.**
 - 75%-80% of the U.S. economy is driven by the activities and employment of small, unregistered business enterprises, including start-up incubator companies.
 - The concept of a “universal accounting and reporting panacea” would likely have the dramatic effect of increasing the administrative costs to smaller enterprises and thereby increasing the risk of financial failure to those enterprises, i.e. the small GAAP vs Big GAAP issue.
 - Universal, “One-Size” GAAP could have a dramatic effect on the costs of goods and services to the consuming public and ,thereby, stall the U.S. economic growth and development.

Generally, American’s love “One-Size Fits All”!

However, a recently published study by Financial Executives International (FEI) and Baruch College's Zicklin School of Business, suggests, however, that **only 55% of CFO’s support convergence..**

Certain Other Considerations

1. Convergence, coupled with accounting and reporting flexibility, might result in a change in the **educational foundation** for qualification as a CPA, i.e. more emphasis on: **emphasizing:**
 - a. Accounting for the results of business considerations rather than accounting rules with the objective of greater understanding of unique business operations and objectives, i.e. **enhance the ability to account for, and report the effects of, “substance over form”**.
 - b. Flexible, Relevant communications meeting consumer informational needs and levels of sophistication visa vis prescribed formats, line items, and less than understandable disclosures.
 - c. The **use of financial and non-financial information** to estimate the progress of enterprises towards achieving their business objectives and predicting /monitoring the likelihood of market success by developing benchmarks and comparisons throughout the educational process.

2. The European community reportedly prefers **experience over additional education** for **credential qualification**. Is this worth considering?

Could such changes have a
cost-benefit to you
by **enhancing the skills of entry level credentialed professionals**
and, thereby, result in
“Out-of -the- Box” forward thinking, effective accountants and auditors?

The BIG Question, I pose to you is:

Should we devote our resources, dialogue, and efforts to **Convergence**
or, alternatively,
Should we devote our resources to seek Litigation and Regulatory reform
to accommodate the skills, judgment, and commitment to public responsibility
that you, as credentialed professionals,
if freely permitted, are capable of responsibly demonstrating.

In the context of with Convergence Debate,
How Different are we Today?

Let's explore that question by an analysis of the
“Framework” Differences between IASB/IFRS and FASB

Brief Overview of Framework Differences & Similarities

Objectives of Financial Statements

- Primary Objective
- Objective of the Statement of Financial Position
- Concepts of Capital Maintenance

Qualitative Characteristics of Financial Statements

- ✓ Understandability
- ✓ Relevance
- ✓ Materiality
- ✓ Reliability
- ✓ Substance over Form
- ✓ Prudence
- ✓ Timeliness
- ✓ Practicability

Objectives of Financial Statements

Primary Financial Statement Objective

International

The objective of financial statements is to provide information about the **financial position, performance and changes in financial position** of an entity that is *useful to wide range of users in making economic decisions.*

FASB

Financial statements should provide information that is **useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions.** Such information including the following information:

- *Information useful in Assessing Cash Flow Prospects*
- *Information about:*
 - *Enterprise Resources, Claims to those resources, and Changes in them*
 - *Enterprise Performance*
 - *Liquidity, Solvency, and Funds Flow*
 - *Management Stewardship and Performance*
 - *Management Explanations and Interpretations*

Objectives of Financial Statements

International

Users of financial statements are better able to evaluate the ability of an entity to **generate cash and cash equivalents**, including the timing and certainty of their generation, if they are provided information that focuses on the **Financial Position, Performance and Changes in Financial Position** of an entity.

- ✓ **Financial Position** is provided in a **Balance Sheet**
- ✓ **Performance** is reported in an **Income Statement**
- ✓ **Changes in Financial Position** is provided by means of a **Separate Statement** identifying *investing, financing and operating activities* utilizing *choices* among fund types, i.e. **All Financial Resources, Working Capital, Liquid Assets, or Cash.**

The **Balance Sheet** provides information about:

- ✓ the **economic resources controlled** by the entity,
- ✓ its **capacity** in the past **to modify these resources**,
- ✓ **financial structure and ability to borrow, allocate profits and distribute cash outflows flows**,
- ✓ the entity's **liquidity and solvency**, and
- ✓ The entity's **ability to adapt to changes in its operating environment** .

FASB

By contrast, **FASB Concepts Statement No. 6** emphasizes the **informational content, definitions, and definitions of the components of each prescribed financial statement**, thereby, in this DL's view, *increasing the difficulty in comprehending the same basic notions* expressed in the International conceptual statements.

Objectives of Financial Statements

International

Concepts of Capital Maintenance (Only IASB/IFRS)

Session No. 14

A concept of **Capital Maintenance is used** in preparing financial statements. **Two concepts are acknowledged:**

- **Financial Capital Maintenance**;
- **Physical Capital Maintenance**

The concept selected by an entity should be based on the needs of the users of the financial statement.

The selection of concept affects the measurements used in financial statement preparation:

- ✓ **The Financial Capital Maintenance Concept defines profit as the increase in invested purchasing power over a reporting period.**
 - **Net Assets** are measured using **Nominal Monetary Units**;
 - **Profit** is recognized only in the *recorded amount of assets in excess of the increase in the general price levels*;
 - The **difference** is treated as an **Equity Adjustment**.
- ✓ **The Physical Capital Maintenance Concept defines profit as the increase in physical productive capacity during the reporting period.**
 - **Net Assets** are measured **at Current Cost**;
 - **All price changes** affecting assets and liabilities are treated as **Equity Adjustments**.

Certain Qualitative Characteristics of Financial Statements

Understandability:

International

Readily Understandable by Users. However, **relevant information** to the decision-making needs of users **should not be excluded merely because it is too difficult for certain users to understand.**

FASB

Understandability is the quality of information that enables users to **perceive its Significance.**

Relevance:

International

Influences the economic decisions of users by helping them **evaluate past, present, or future events, or confirming, or correcting their past evaluations.**

FASB

The capacity of information to **make a difference in a decision** by helping users to **form predictions** about the outcomes of past, present, and future events or to confirm or correct prior expectations. **Feedback Value** is the quality of information that enables users to confirm or correct prior expectations

Certain Qualitative Characteristics of Financial Statements

Materiality

International

An omission or misstatement that could **influence users' decisions**. **Materiality** depends on the **size of an item or error** judged in the **particular circumstance of its omission or misstatement**.

FASB

The **magnitude** of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it **probable that the judgment of a reasonable person** relying on the information **would have been changed or influenced by the omission or misstatement**.

Substance over Form

International

To represent faithfully, transactions and other events should be **accounted for and presented in accordance with their substance and economic reality** and not merely their legal form.

International

Prudence

Caution in the exercise of judgments needed in **making the estimates** required under **conditions of uncertainty**

Certain Qualitative Characteristics of Financial Statements

Timeliness

International

The overriding consideration in achieving a **balance between relevance and reliability** is *how to best satisfy the decision-making needs of users*,

Untimely information may lose its **Relevance**.

The **uncertainties** associated with complex, forward looking **measurements** may dramatically affect the **Reliability** of the information.

FASB

Having information available to a decision maker *before it loses its capacity to influence*.

Practicability (a pervasive constraint)

Both the IASB and FASB acknowledge that “**the exercise of professional judgment**” is **necessary to** evaluate whether the “benefit to users derived from information exceeds the cost of producing that information

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The IASB Framework does not override any specific International Accounting Standard.

The **IASB** acknowledges that the **Conceptual Framework** applies to **preparers of general purpose financial statements** and **auditors** as well as standard setters to **guide accounting decisions in absence of any specific standard for a specific measurement or disclosure issue.**

The IASB Framework also states:

- ✓ The **IASB** places **primary importance** on the characteristics of:
 - *Understandability;*
 - *Reliability*
 - *Relevancy, and*
 - *Comparability*

Conversely, The **FASB**, in SFAS. No 107, **implies** that the concept of **“Practicability”**, i.e. **cost-benefit considerations**, may **override** the characteristics of both **comparability and consistency.**

The IASB Framework acknowledges that, when applicable, professional judgment must be applied to decide the relative importance of each of the set of qualitative characteristics to satisfy the needs of a particular set of users.

- ✓ **Certain users rely on financial statements as their major source of information for their needs.**

Accordingly, such “special purpose” financial statements should be prepared to satisfy their needs.

The Framework may be applied in preparing those statements.

Against this backdrop, **remember** a couple of **Basic Points**:

- **Debits** must still equal **Credits**;
- The requirement for *recorded* **Transaction Completeness** is unaffected;

In this DL's view,
the issue boils down simply, to the
appropriate latitude for the exercise of
Professional Judgment
permeated with Integrity and Objectivity.

My assessment is that
IASB states more Clearly and Consistently
a requirement to stay focused on the
Needs of Users
In the preparation of general purpose financials.

FASB states clearly that **Materiality** is the **Benchmark**.

Is this merely a question of semantics?

OR

Are we, as a Profession, focused too narrowly in this debate, e.g.

Rule Conformity vs Users' Needs and Expectations?
Coupled with
Latitude for Professional Judgment shielded from **Litigious and Regulatory**
constraints?

YOU are the PROS.
How do you see this Issue?

Resources

- **Smartpros.com**
- **Search: PWC. KPMG, Ernst, Delloitte;** Then for each site
Search: IFRS

**Now,
Let's examine the judgments embodied in
Current U.S. GAAP relative to Fair Value Accounting
And
See if IAS would help.**

Fair Value Accounting

SFAS No. 157

Critical Definitions and Terminology:

1. **Fair Value** – The **gross price** that is **expected** to be ***received by the seller*** (exit price) when disposing of an asset or ***paid by the obligor*** to transfer a liability at the measurement date in an ***orderly transaction*** between ***market participants***, assuming:
 - ✓ An asset's value is the maximum value applicable to the hypothetical purchaser, or
 - ✓ A liability is subject to the same nonperformance risk to the obligor before and after the hypothetical transfer.
2. **Market Participants** – Buyers and Sellers in the principal (or most advantageous market) who are unrelated and informed, motivated to purchase, and capable of executing the transaction.
3. **Orderly Transaction** – Not a hypothetical forced liquidation or distress sale.
4. **Particular Asset or Liability** – Refers to the level at which the object of measurement is aggregated (disaggregated), ***by the reporting entity***, for purposes of applying other accounting pronouncements, i.e. stand-alone or in conjunction with other items.
5. **Highest and Best Use** – *Assuming that the use of an asset by prospective Market participants (purchasers) is physically possible, legally permissible, and financially feasible, highest and best use is the valuation assumption (for an asset or group of assets) that the price expected to be received by the reporting entity would maximize the (operational) value of the particular Asset (Group) based upon the intended use of the item(s) by the hypothetical prospective purchaser(s), e.g. The incremental increase in (operational) value to prospective market participants either as a **standalone** asset or **in conjunction with other assets used as a group** and those other assets would also be **available to prospective market participants** (purchasers).*
6. **Valuation Premise** – The reporting entity's assumption about intended use by market participants regardless of the level of aggregation (disaggregation) of the asset for other accounting purposes e.g. *what is the **motivation** to market participants (hypothetical purchasers) to seek the asset in an orderly market transaction.*
7. **In-Exchange Valuation Premise** – **The reporting entity assumes** that the maximum value would accrue to market participants principally on a ***standalone*** basis.

8. ***In-Use Valuation Premise*** – **The reporting entity assumes** that the maximum value would accrue to market participants principally if the asset is used in ***conjunction with other assets*** as a group (installed or otherwise configured for use)

Critical Definitions and Terminology (Continued):

9. **Valuation Technique** – The methods used to estimate the Fair Value amount, i.e. market approach, income approach, or cost approach:
10. **Market Approach**: Comparable prices generated by market transactions;
11. **Income Approach**: Discounted values indicated by market expectations of future amounts;
12. **Cost Approach**: Current cost to replace the *service capacity* of the asset
13. **Inputs to Valuation Techniques**: Assumptions based upon **Independent Observable** market behavior or, *in the absence of observable market behavior*, **Internally Developed** assumptions about **assumed market response to the availability of the reporting entity's asset(s) for acquisition or that would facilitate the transfer of the reporting entity's liabilities**, adjusted for other information, available to the reporting entity without undo cost and effort, likely to affect the assumed market participants' motivation(s) to transact.
14. **Principal Market** – The market with the greatest volume and level of activity for the particular asset or liability subject to measurement by the reporting entity.
15. **Most Advantageous Market** – The market in which the reporting entity would sell the asset or transfer the liability to maximize the amount received to sell an asset or minimize the amount paid to transfer a liability :
 - ✓ *In the absence of a principal market, and*
 - ✓ *After consideration of transaction costs in the respective markets.*

Applicability:

FASB Statement No. 157, *Fair Value Measurements*, is the current authoritative guidance intended to promote consistency in (a) the definition of fair value, (b) the methods used to measure fair value, and (c) to improve the content and location of related disclosures. Accordingly, numerous pre-existing pronouncements have been amended to make reference to the revised guidance.

*FAS No. 157 is effective for FYE after November 15, 2007
With limited exceptions, the application of FAS No. 157 is applied Prospectively*

Fair Value measurements principally apply to particular Assets and Liabilities.
However, Instruments measured at Fair Value classified in stockholders' equity are also within the scope of FAS No. 157.

Fair Value measurements **do not apply** to the following pronouncements:

- *Share-based transactions (FAS 124 and related pronouncements);*
- *Inventory (ARB No.43);*
- *Pronouncements that require or permit measurements based on, or otherwise use, vendor-specific objective evidence of fair value, e.g. SOPs 97-2 and 98-2, Software Revenue ... and related pronouncements.*

Constraints:

- **Materiality, and**
- **Practicability,**
- **Other Accounting Pronouncements**

Materiality and *Practicability*:

In the author's view,
***Materiality and Practicability* are *inextricably linked*.**

Financial information must be reliable, timely, and relevant to the decision makers needs to be useful. Accordingly, there is a cost-benefit relationship:

- **Materiality** addresses the ***importance of the information*** to the decision maker(s), e.g. investors and creditors, and
- **Practicability** focuses on the ***cost*** to produce that benefit in a ***timely manner***.

Materiality, therefore requires the exercise of an ***informed judgment*** about the relevancy of reported information for the decision making needs of expected ***reasonably informed user(s)*** of that information.

Practicability is a quantitative evaluation of the cost and effort (potential time delay) involved in the processes necessary to obtain and report the level of specific information desired by those expected ***reasonably informed users*** of the information provided.

Practicability is stated specifically in the following pronouncements to be
an allowable exception
to the Fair Value measurement requirements of FAS No. 157:

1. *Pensions /Other Retirement Benefits (FAS Nos. 87 and 106)*
2. *Fair value instruments (FAS No. 107)*
3. *Contributions Received and ... Made (FAS No. 116)*
4. *Transfers of Assets and Extinguishment of Liabilities (FAS No. 140)*
5. *Business Combinations (FAS No. 141)*
6. *Asset Retirement Obligations (FAS No. 143)*
7. *Costs Associated with Exit or Disposal Activities (FAS No. 146)*
8. *Nonmonetary transactions (APB 29)*
9. *Exchanges of Nonmonetary Assets (FAS No. 153)*
10. *Guarantor's Accounting for Guarantees (FIN No. 45)*
11. *Certain other authoritative guidance specific to more narrow transactions*

Furthermore,

PRACTICABILITY is recognized in ***SFAS No. 157*** if the **Inputs are Unobservable!!**

Other Accounting Pronouncements:

1. Those ***pronouncements stated above*** which are subject to stated **Practicability Constraints**
2. **Transaction Costs** shall not be deducted from the gross expected price when measuring fair value. Those costs shall be accounted for in accordance with other accounting pronouncements, e.g. *selling expense as opposed to reduced revenue* (FAS No. 144, ... Impairment ... of Long-Lived Assets)
3. **Related Parties** as defined in FAS No. 57.
4. Pronouncements which are **not included within the scope of FAS NO. 157**, including:
 - a) ***Share-based transactions*** (FAS 124 and related pronouncements);
 - b) ***Inventory*** (ARB No.43);
 - c) ***Pronouncements that require or permit measurements based on, or otherwise use, vendor-specific objective evidence of fair value, e.g. SOPs 97-2 and 98-2, Software Revenue ... and related pronouncements.***
5. Authoritative Pronouncements referring to fair value **not amended** by FAS No. 157, including related Technical Bulletins and FASB Staff Positions:
 - a) Equity Method Accounting (**APB No. 18**)
 - b) **Lease Accounting** guidance:
 - i. Inception of a lease (**FAS No. 23**)
 - ii. Accounting for Sales with Leasebacks (**FAS No. 28**)
 - iii. Leases of Government Property (**FIN No. 23**)
 - iv. Leases of Only Part of a Building (**FIN No. 24**)
 - v. Accounting for Leases (**FAS No. 98**)
 - c) Franchise Revenue (**FAS No. 45**)
 - d) Title Plant (**FAS No.61**)
 - e) Sales of Real Estate (**FAS No. 66**)
 - f) Research and Development (**FAS No. 68**)
 - g) Induced Conversions of Debt (**FAS No. 84**)
 - h) Creditor Accounting for Impaired Loans (**FAS No. 114**)
 - i) Nonpublic Company Disclosure exemption for Financial Instruments (**FAS No. 126**)
 - j) Derivatives and Hedging (**FAS Nos. 138 and 139**)
 - k) Consolidation of Variable Interest Entities (**FIN 46 and 46(R)**)
 - l) Conditional Asset Retirement Obligations (**FIN 47**)

FASB No. 157 provides a framework for Estimating Fair Value.

FAIR VALUE measurements require the reporting entity to determine:

1. The **Specific** asset or liability subject to measurement, consistent with the items *Unit of Account*;
2. The **Valuation Premise** for that particular asset or liability;
 - a) **Highest and Best Use** – *Assuming that the use of an asset by prospective Market participants (purchasers) is physically possible, legally permissible, and financially feasible, highest and best use is the valuation assumption (for an asset or group of assets) that the price expected to be received by the reporting entity would maximize the (operational) value of the particular Asset (Group) based upon the intended use of the item(s) by the hypothetical prospective purchaser(s), e.g. The incremental increase in (operational) value to prospective market participants either as a standalone asset or in conjunction with other assets used as a group and those other assets would also be available to prospective market participants (purchasers).*
 - b) **Valuation Premise** – The reporting entity’s assumption about intended use by market participants regardless of the level of aggregation (disaggregation) of the asset for other accounting purposes e.g. *what is the motivation to market participants (hypothetical purchasers) to seek the asset in an orderly market transaction.*
 - c) **In-Exchange Valuation Premise** – **The reporting entity assumes** that the maximum value would accrue to market participants principally on a *standalone* basis.
 - d) **In-Use Valuation Premise** – **The reporting entity assumes** that the maximum value would accrue to market participants principally if the asset is used in *conjunction with other assets* as a group (installed or otherwise configured for use)
3. The **Principal or Most Advantageous Market** for the specific asset, assuming the asset’s highest and best use;
4. The principal or most advantageous market for the specific liability;
5. The appropriate **Valuation Technique(s)** applicable to the measurement, considering:
 - a. The **Availability of Data** with which to develop the assumptions that market participants would use in arriving at an exchange price, **and**
 - b. The **Level of** the inputs within the **Fair Value Hierarchy**.

The Fair Value Hierarchy

The **FAIR VALUE HIERARCHY** categorizes **INPUTS** to the valuation technique but does not prioritize valuation techniques (models and methodology)

INPUTS mean “the assumptions that likely purchasers would use in establishing the exchange price the purchaser would be willing to pay” including the hypothetical market participant’s assumptions about the following risks:

- Risk inherent in the valuation technique, and
- Risk inherent in developing their exchange price assumptions (**Inputs**)

Level 1 Inputs

- **Observable , Established Market Inputs** to which the reporting entity has access., e.g. quoted market prices for *identical* assets or liabilities

Level 2 Inputs

- **Observable , Established Market Inputs** to which the reporting entity has access., e.g. quoted market prices for *similar* assets or liabilities

Level 3 Inputs

- **Unobservable Inputs** are the reporting entity’s own assumptions about market participant’s assumptions after consideration of any *practicable market information* and *entity specific data, i.e. What is the Assumed Economic Benefit to an open market participant (hypothetical purchaser within a group of hypothetical purchasers)?*

NOTE:

Where fair value is based upon bid-ask prices the price within the spread between the bid-ask spread that is most representative shall be used regardless of the category under the hierarchy.

Recognize!!

1. **FAIR VALUE** is the expected gross exchange price to be received by the reporting entity, and
2. **Disclosures** will contain a detailed explanation of how the expected amount to be received was determined, i.e. **a description of how the reporting entity applied the Valuation Framework and determined the reported amount.**

VALUATION TECHNIQUES

The appropriate models and formulas used to
“Punch Out the Number or Range of Numbers” .

SFAS NO. 157 **ONLY** prioritizes the **Inputs** to the Technique.
**Judgment is required to select the
appropriate technique or combination of techniques.**

Valuation Techniques should be consistently applied.

However, prospective adjustments resulting from a change in technique are permitted and treated as a Change in Estimate under certain conditions.

See the next page.

SFAS No. 157 requires that valuation techniques consistent with the following approaches shall be used to measure fair value:

- **Market Approach** – Prices and other information generated by broad market transactions for *identical or comparable items*, including Matrix Pricing Models.
- **Income Approach** – Discounted Present Value techniques to convert future earnings or cash flow estimates, e.g. *techniques outlined in FASB Concept Statement No. 7, the Black-Scholes-Merton formula, Binomial (Lattice) models, and the excess earnings approach for certain intangibles.*
- **Cost Approach** – The cost to an hypothetical market buyer to acquire or construct a substitute asset of comparable utility, adjusted for the obsolescence of the reporting entity’s unit.

The objective of all of this is to **estimate the most representative amount *expected to be received by the reporting entity*** based upon the **best available information** at the measurement date.

How should you classify Fair Value Adjustments?

SFAS No. 157 is effective for fiscal years ending after November 15, 2007.

Adjustments upon Adoption:

Generally any fair value adjustments upon adoption are applied prospectively as of the beginning of the first fiscal year.

A modified-retrospective requirement (*cumulative effect of a change in accounting principle*) is required for:

- Positions in a financial instrument held by Broker-Dealers or Investment Companies utilizing a blockage factor to measure fair value, and
- Certain Derivative Financial instruments.

Subsequent Fair Value Adjustments are classified in accordance with **existing pronouncements** *UNLESS* the adjustments result from a change in valuation technique or the application of the technique, e.g. changes in weighting techniques when multiple-valuation techniques are used, new markets develop, relevant information changes, or valuation techniques improve.

Such adjustments are also applied prospectively as a *Change in an Estimate* under SFAS NO. 154, Accounting Changes and Error Corrections. **The disclosure requirements of SFAS No. 154 for a change in an estimate are not required.**

DISCLOSURES

The GOOD NEWS !!

The **expanded disclosure requirements** of this pronouncement **may be combined** with the **disclosure required by other pronouncements**.

The following expanded disclosures apply to each major category of assets and liabilities:

- The Fair Value amounts;
- Information to enable users to evaluate the reliability of the inputs, e.g. what category of inputs were significant, Level 1, 2, or 3;
- The valuation technique(s) used and any changes in technique or application of the technique.

Certain additional specific disclosures apply to those measurements that:

- Use unobservable inputs, or
- Are nonrecurring.

Quantitative Disclosures are required to be presented in **Tabular Form**.

AND Now COMES

LET's DO IT GAIN, Sam

SFAS NO. 159, *The Fair Value Option for Financial Assets & Financial Liabilities*

All types of reporting entities have an option to

ELECT

Fair Value Accounting

for other

ELIGIBLE

Financial Assets & Liabilities

On an Instrument by Instrument Basis

The Election may be made when:

- **An Eligible Item is First Recognized in the financial statements;**
- **Specialized treatment ceases for an item previously accounted for under fair value guidance specified in *Specialized Accounting Guide*;**
- **An investment becomes subject to the equity method of accounting;**
- **An investor ceases to consolidate a subsidiary or VIE but retains an equity interest;**
- **An eligible item is required to use fair value accounting at inception but no fair value adjustment is required in subsequent periods.**

Eligible Items

- **Financial Assets, Liabilities, and Firm Financial Commitments;**
- **Warranties permitting settlement in goods and services**
- **Certain insurance contracts permitting settlement in goods or services**
- **Guarantees of third-party leases and contingent liabilities related to cancelled leases**
- ***Bifurcated Host Derivatives***

INELIGIBLE ITEMS

- **Investments in Consolidated Subsidiaries or Consolidated VIEs**
- **Employee Benefit Plans**, including stock option plans, stock purchase plans, and deferred compensation plans;
- **Leased Assets & Obligations**, except as noted above;
- **Components of Shareholders Equity**
- **Deposit Liabilities**

DISCLOSURES

SFAS No. 159 does not change the disclosure requirements of other pronouncements.

However,
Certain specific disclosures are required.

- **Management's reasons for electing the fair value option for each eligible item or group of similar items.**

Although the fair value option may be elected for a single eligible item without electing to apply the option for other identical items,

There are 4 exceptions to that principle:

1. If multiple advances are made to a borrower pursuant to a master loan agreement, the option applies to the cumulative balance outstanding, not the individual advances;
 2. If the option is elected for an investment that would otherwise be accounted for under the equity method of accounting, fair value measurements apply to all of the investor's financial interests in the same entity;
 3. If the option is elected for an insurance or reinsurance contract, it shall be applied to all claims and obligations under the contract.
 4. Integrated or nonintegrated features (Riders) to an insurance contract the option is applied to all the features.
- If the **election is made for some *but not all eligible items within a group*** of eligible items:
 - A description of the **similar items** and the **reasons for the partial election**, and
 - Information to enable users to understand how the group of similar items relates to individual balance sheet line items.
 - For **each line item in the balance sheet that includes items for the election has been made**:
 - Information to enable users to understand how each line item relates to major categories of Assets and Liabilities;
 - The aggregate carrying amount of items included in each line item that are not eligible for the fair value option, if any.

- The difference between the aggregate fair value and the unpaid contractual balance of **Loans, long-term receivables, and long-term debt instruments** *for which the fair value option has been elected.*
- For **loans held as assets** for which the **option** has been **elected**:
 - The aggregate fair value of loans that are 90 days or more past due;
 - If the entity records interest income separately from fair value adjustments, the aggregate fair value of loans in nonaccrual status;
 - The difference between the aggregate fair value and the aggregate unpaid principal balance for loans that are 90 days or more past due, in nonaccrual status, or both.
- For **investments** that would have been accounted for under the **equity method** had the election not been made, the disclosures of Par. 20 of APB #18, ...The Equity Method of Accounting for Investments in Common Stock are applicable, i.e. ***name(s) of the investee(s), percentage of common stock ownership, Accounting policies for investments in common stock, and, when necessary summarized information on assets, liabilities and results of operations.***