CPE

CURRICULUM:
Accounting and Auditing

LEVEL:
Basic

DESIGNED FOR:
CPAs in public practice

PREREQUISITES:
None

ADVANCED PREPARATION:
None

OBJECTIVES:
To provide information CPAs need to know to review fair value measurements (FVMs), identify the typical errors and omissions that CPAs should look for in any consideration of an FVM, and summarize best practices for CPAs who are developing and reporting FVMs.

KEY TOPICS:
First principles, when FVMs apply, related term definitions, differences between fair value measurements and fair market value valuations, and top 10 best practices for developing and reporting a fair value measurement

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What CPAs Need to Know About Fair Value Measurements

By Robert F. Reilly, CPA

CPA valuation analysts are often asked to develop and report on a fair value measurement (FVM) for financial accounting purposes. For purposes of this discussion, an FVM is a valuation analyses prepared in compliance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) topic 820, *Fair Value Measurement*. This discussion focuses on FVMs developed to comply with ASC topic 805, *Business Combinations*. However, as explained below, FVMs may be developed for many financial accounting purposes.

CPA valuation analysts are sometimes asked to review FVMs prepared by other analysts – whether those other analysts are CPAs or not. To borrow a term from the Uniform Standards of Professional Appraisal Practice (USPAP), these analyses are sometimes called review appraisals. These review appraisals are sometimes developed as part of the financial statement audit process. But these review appraisals may also be developed for financing purposes, forensic analysis purposes and other purposes.

CPA auditors often have to review and rely on FVMs as part of the financial statement audit process. Some larger public accounting firms may have valuation analysts on staff to assist the auditor. But, often, the auditor has to perform the audit examination of the FVM.

CPA controllers and chief financial officers (CFOs) may have to select, retain and rely on CPA valuation analysts to develop the FVM. Such controllers and CFOs should have sufficient expertise to allow them to accept the FVM and incorporate the FVM conclusions into their company's financial statements.

The scope of this article does not include a comprehensive explanation of FVM approaches, methods and procedures. Rather, the article does provide the minimum the CPAs need to know to review FVMs. In particular, this discussion identifies the typical errors and omissions that CPAs should look for in any consideration of an FVM.

First, this article reviews what CPAs should know about the first principles related to FVMs developed for U.S. generally accepted accounting principles

FVM is a valuation analyses prepared in compliance with the **Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) topic 820, *Fair Value Measurement*.**

(GAAP) compliance purposes. Second, this article summarizes best practices for CPAs who are developing and reporting fair value measurements. In particular, this article recommends best practices for avoiding the top 10 most typical FVM errors and omissions. Third, this article recommends best practices for handling other (but still common) FVM issues. Finally, this article presents CPA caveats and recommends reporting best practices related to valuation analyses prepared for various financial accounting purposes.

This article focuses on best practices related to an FVM developed with regard to the allocation of a business combination transaction purchase price. However, many of the best practices recommended also apply to an FVM developed for other financial accounting purposes.

FAIR VALUE MEASUREMENT FIRST PRINCIPLES

ASC topic 820, *Fair Value Measurement*, defines the term fair value as follows: "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. "This ASC topic 820 fair value definition includes several important considerations with regard to the hypothetical fair value transaction. The requirements for such a fair value transaction include the following:

- An orderly transaction;
- A transaction between market participants;
- A transaction in the principal or the most advantageous market; and
- A transaction value indicating an exit price.

ASC topic 820 provides rules-based guidance to both CPA valuation analysts and auditors with regard to the following FVM considerations:

- Valuation principles and methodologies;
- Valuation techniques; and
- A hierarchy of valuation analysis inputs

When Do Fair Value Measurements Apply?

The following ASC topics provide professional guidance with regard to transactions and/or events in which an FVM applies:

- ASC 718 – share-based payments
- ASC 410 and 440 – asset retirement obligations
- ASC 805 – business combinations
- ASC 460 – guaranties
- ASC 845 and 605 – nonmonetary transactions
- ASC 420 – restructuring obligations
- ASC 852 – reorganization "fresh start accounting"
- ASC 350 – goodwill impairment
- ASC 360 – long-lived asset impairment
- ASC 320 – investments – debt and equity securities
- ASC 321 – investments – equity securities

This article focuses on an FVM developed and reported with regard to ASC topic 805, *Business Combinations*. That is, these best practices relate to an FVM developed for allocation of purchase price purposes within the context of a business combination. Nonetheless, many of the best practices recommended in this discussion also apply to an FVM developed for other financial accounting purposes.

When Do Fair Market Value Valuations Apply?

To better understand an FVM, it may be helpful to contrast an FVM with a fair market value valuation. A fair market value (FMV) valuation may be developed for numerous nonfinancial accounting purposes, including the following:

- Federal income tax compliance;
- Federal gift and estate tax compliance;
- Bankruptcy;
- Financings;
- Transaction structurings;
- Commercial contracts; and Other

FMV valuations are typically developed when the purpose of the analysis is to emulate the negotiation considerations of a willing buyer and a willing seller.

Differences Between Fair Value Measurements and Fair Market Value Valuations

An FVM (developed for financial accounting compliance purposes) and an FMV valuation (developed for other purposes) have numerous conceptual and practical differences. Both CPA valuation analysts and auditors should be aware of these differences.

An FVM is a rules-based analysis, with the analysis rules provided primarily by ASC topic 820. An FVM applies in many financial accounting compliance situations. In contrast, an FMV valuation is a judgment-based analysis. Applying independent professional judgement regarding valuation approaches, methods and procedures, an independent appraiser attempts to emulate a market transaction in the development of the FMV valuation. FMV valuations often apply in transactional situations – but they do not typically apply in financial accounting compliance situations.

DISCUSSION DEFINITIONS

This discussion applies the definitions presented as follows. The term "analyst" means any valuation specialist in any property appraisal discipline (including business, real estate, tangible personal property, and intangible personal property). The term "principal analyst" is the individual with overall responsibility for the allocation of purchase price FVM engagement team. The term "best practices" represents the general consensus regarding current valuation profession practices and procedures. That is, the term "best practices" does not imply either valuation professional standards generally or allocation of purchase price engagement requirements specifically.

TOP 10

Best Practices for Developing and Reporting a Fair Value Measurement

This section presents 10 recommendations for analysts who are developing an FVM for financial accounting purposes. For the most part, these best practices assume an FVM developed for ASC topic 805 compliance purposes. However, most of these best practices would also apply to an FVM developed for other financial accounting purpose.

1. Review the Transaction Documents

2. Consider That At-Market Contracts May Have Intangible Asset Value

3. Value the Acquired Liabilities – Not Just the Acquired Assets

4. Apply the CEEM or MEEM at Least Once

5. Analyze the Economic Obsolescence Measurement

6. Document and Disclose the Useful Economic Life Assumption

7. Ensure WACC = WARA = IRR

8. Develop a Goodwill Valuation

9. Develop an Assembled Workforce Valuation

10. Consider the Tax Amortization Benefit Adjustment in Certain Intangible Asset Valuations

Go to www.tx.cpa/resources/today's-cpa for more information on these practices, as well as best practices for other fair value measurement issues and to take the CPE Quiz.

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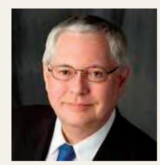

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