

# Changing measurements

How to learn more about the recent changes to fair value accounting standards **Interviewed by Meredith McKenzie**

**F**air value accounting is changing, and businesses need to adapt to the new standards to ensure they have followed the new guidance.

Over the past few years, the Financial Accounting Standards Board (FASB) has made several changes to fair value accounting standards. The board has also developed a consistent methodology to determine fair value, and amended the standards to get rid of the six different methodologies previously in place. One of the proposed changes currently being evaluated is for entities that meet certain criteria to measure their investment properties at fair value.

“While it is somewhat controversial still, providing market value information and requiring companies to record certain assets at market value gives a better picture of their financial situation,” says Paul Anderson, CPA, director of assurance services with GBQ Partners LLC.

*Smart Business* spoke with Anderson about the key things you need to know regarding the new fair value accounting standards and how to prepare for any future changes to these standards.

## What are some key things you need to understand about fair value accounting standards?

The first key thing for business owners to understand is that not all assets are recorded at fair value as part of these changes. There are some liabilities that are also recorded at fair value, but not all of them. For example, property and equipment is not valued at fair value, it is still valued at historic cost. Goodwill is valued at historic cost, unless there has been an impairment determination. Marketable securities and other financial assets are usually recorded at fair value.

The second key is to understand the mechanics of fair value, and how it is determined. There are three methods of determining fair value, which vary in terms of the amount of objectivity involved. At the high end, there’s a marketable security, where you can go right to the *Wall Street Journal* or Google and determine the price. On the other end of the spectrum, you might determine fair value by using an independent valuation. This can be highly subjective, because it is based on the assumptions that an appraiser will use.



**Paul Anderson, CPA**  
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## How do you go about determining fair value?

Fair value, as defined, is an estimation of what would be received for an asset or paid to assume a liability in an orderly transaction. How fair value is determined depends on the type of asset or liability, as well as the availability of the objective information. For example, a marketable security is the most reliable and easiest way to determine fair value. There’s a middle ground that looks at the value of similar assets or liabilities. The third and least reliable method is management’s own method, or the use of an appraiser or valuator to determine the fair value. The reliability and validity of a valuation is higher when less subjectivity is involved in the process.

## How do you prepare for the fluctuations in the fair value that you see from year to year?

It’s not so much preparing as it is just being willing to understand and explain the fluctuations when the changes do occur. The changes are really caused by market forces outside your control. For example, if housing prices decline by 20 percent and you are a homebuilder with a lot of land, it’s possible that your land

prices are going to go down. That is outside of your control.

## What are the risks and benefits associated with fair value accounting standards?

We just went through a period of fairly significant economic downturn that some people believe was partly caused by fair value accounting. One of the risks is that in unsettling financial times with greater market fluctuations, these factors can cause greater fluctuation in financial results. It depends on how much of the assets or liabilities are marked to market. That’s the biggest risk of fair value accounting. The second risk would be the ability to accurately determine fair value, because it’s a moving target.

The biggest benefit to fair value is that most people would think that by marking to market, you’re able to determine what something is really worth. An asset on the books at fair value usually has a more accurate valuation than its historic cost.

## Do you see any more changes coming to fair value?

Yes, I do. The movement to fair value is still a work in progress, and it’s come a long way. If you go back several years ago, nothing was marked to market and everything was at historic cost. We slowly have been moving down this path. There are proponents of fair value accounting who would like to see the whole balance sheet based on fair value. Right now I don’t believe FASB has the appetite for that because it would cause a lot of complexity.

The second issue is that FASB is dealing with whether or not it is appropriate to have small company GAAP. A proposal being considered would allow a set of modifications and exceptions to GAAP for smaller, private companies. It is not certain if the small company GAAP will be approved or whether fair value will be one of the exceptions. It’s all on the table, and no one’s quite sure where we’re going. <<

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