DRESNER
VALUATION SERVICES

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SFAS 157: Fair Value Measurements

With the recent issuance of SFAS 157, Fair Value Measurements, the Financial Accounting Standards Board ("FASB") has endeavored to provide a comprehensive set of accounting standards to determine the current fair value estimates of a company's assets and liabilities. SFAS 157 provides a framework for measuring fair value and takes a major step toward the convergence of U.S. GAAP and International Financial Reporting Standards ("IFRS"). Furthermore, in moving away from the concept of historical cost and toward current market value, the FASB hopes to improve information transparency for the users of financial statements, leading to more efficient capital markets for investors.

In the world of financial reporting, public companies are often faced with the task of estimating the fair value of long-lived assets (fixed assets, intangible assets, and goodwill). The reasons for estimating fair value could be a recent acquisition (purchase price allocation per SFAS 141) or measuring the impairment of a reporting unit based on one of a number of triggering events (SFAS 142). Even though SFAS 157 does not require public companies to value any additional assets for financial reporting purposes, SFAS 157 will change the way assets are valued to comply with SFAS 141 or SFAS 142.

For many years, prior to SFAS 157, valuation professionals utilized the standard definition of "fair market value" which could be found in IRS Revenue Ruling 59-60:

> *Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.*

The new definition of fair value in SFAS 157 focuses on the price that would be **received** if the asset were sold or the liability were transferred (**an exit price**) rather than the price that would be **paid** to acquire the asset or received to assume the liability (**an entry price**). This shift in emphasis to an exit price will force valuators to ask tough questions to understand the general market conditions that pertain to the asset under consideration.

- First and foremost, who are the market participants and potential buyers in the market? A stratification of key industry players into different classes of strategic buyers, financial buyers, etc. would be the first step to understanding the potential buyers for any asset. An understanding of the business model of each market participant along with uses for a particular asset would provide the initial inputs into understanding the potential market for an individual asset.

- What is the highest and best use for an asset? Would excess real estate have a higher fair value as a parking lot or a condominium? According to FAS 157, the fair value based on highest and best use is estimated to be the higher of these two values as long as certain criteria have been met. The criteria of highest and best use focus on feasibility and legality issues.

- What valuation premise (in use, in exchange, etc) is most relevant in determining the highest and best use of an asset? Is an asset more valuable installed in its present location in Chicago, moved to a plant floor in Tulsa, or sold to an auctioneer in Knoxville? The cost/benefit trade-off of these types of scenarios must be considered in the fair value analysis.

- What is the principal or most advantageous market for an asset? The principal market is the market with the greatest volume and level of activity and the most advantageous market maximizes the amount that would be received. In the fair value assessment, the fair value based on the principal market will supersede the most advantageous market even if the fair value of the asset is higher in the most advantageous market. Consequently, a market analysis of where an asset would be sold is an important part of the fair value analysis.

Another ramification of SFAS 157 is establishing a fair value hierarchy that distinguishes between observable inputs using current market data and unobservable inputs based on the best information available. The Statement dictates that valuation techniques should maximize the use of observable inputs and minimize the use of unobservable inputs. A three level hierarchy is used to classify inputs in the measurement of fair value:

Level 1 inputs are observable inputs from currently quoted prices in active markets for identical assets or liabilities. (e.g. the company's own publicly-quoted stock price)

Level 2 inputs are observable inputs, such as current quoted prices for similar assets, historical prices, or quoted prices from inactive markets. (e.g. comparable public companies)

Level 3 inputs are unobservable inputs, such as projected financial information for an asset or liability. (e.g. discounted cash flow analysis)

In our next publication, we will address key changes to accounting for business combinations outlined in SFAS 141R, including the treatment of contingent consideration, transaction expenses, and in-process R&D. SFAS 141R is scheduled to go into effect for business combinations with an acquisition date in the first annual reporting period after December 15, 2008.

If you have any questions about SFAS 157, please give us a call at Dresner Valuation Services. We would be pleased to assist you with all of your accounting and tax-related valuation needs.

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