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Focus on Financial Reporting Helps Treasurers Manage Risk, Careers

Recent Financial Accounting Standards Board activity suggests continued momentum in the shift from historical cost based to fair value accounting, and a growing need for treasurers to be engaged in the financial reporting process, both to manage risk and to enhance their careers, one expert says.

"With fair value reporting, the treasurer's role of managing expectations about cash is overlapping with the financial reporting process," says John Rieger, Director of Financial Accounting and Reporting for the Association for Financial Professionals (AFP).

A Gradual Transition

The shift to fair value accounting began in the 1980s. Before then, corporate accounting was mainly about keeping historical records of company transactions. In other words, whenever the company paid for something, the accountants would record the transaction's cost in the financial statements. If an investment lost value, the loss didn't have to be recorded in the financials until the company relinquished the investment.

Unfortunately, this approach led to unhappy investors in a number of cases where companies delayed disclosure of investment losses.

In response, FASB began the gradual transition to an approach that requires corporations to include in financial statements numbers that reflect the fair market value of assets and liabilities at period end.

"FASB first focused on marketable securities and investments," Rieger explains. "But since the late '80s, it has generated a flurry of new statements based on the fair value concept."

These FASB statements have called for a fair value approach to accounting for a range of assets and liabilities, including equity investments, stock options, derivatives, business combinations and intangibles, among others.

Recent Developments

Following up its many years of statements requiring a fair value approach to valuing specific classes of assets and liabilities, FASB last fall issued a statement (No. 157 – Fair Value Measurements) offering a methodology for executing this approach.

And, since the beginning of this year, the board has requested and received comments from constituents about the need for more guidance on implementing FAS 157, and announced plans to form a resource group to assist the board in developing such guidance.

"Fair value gets even more complicated with international or global companies," Rieger says. "There are all kinds of new and different valuation factors based on volatility and risk that you have to consider."

An Emerging Treasury Issue

Before fair value accounting, investors looked to brokers, the media and their own analysis to make determinations about a company's value. "But what FASB has been doing is shifting that valuation burden on to management and the board of directors," Rieger says.

Inevitably, treasurers will be forced to play a pivotal role in this new valuation model, he says.

"The treasurer's role and responsibility is to manage the current and expected cash flow needs of the company, by calculating and projecting those cash flows," Rieger explains. "And that's exactly the basis for fair value."

He gives the example of a corporation that purchases another company for $1 million. "Under fair value accounting, what I book on the corporation's balance sheet is not necessarily $1 million, but rather the present value of the expected future cash flow return that it is anticipated that the company assets and liabilities will generate."

And whose job is it to make those projections? It's generally the treasurer's, Rieger notes, and so management will be looking to the treasurer for information and assistance on making judgments critical to financial reporting.

Managing Fair Value Risk

As the fair value approach increasingly dominates US generally accepted accounting practices (GAAP), treasurers will need to manage the risk that this creates — both for their companies and their jobs. Treasurers will now find themselves in the eye of the storm if the valuations reflected in the financials vary significantly from their cash flow projections.

"If that happens, someone is going to be held accountable," Rieger warns. He recommends that treasurers respond to these new risks in several ways:

- Familiarize yourself with the assets and liabilities on the balance sheet that are being valued, and how those valuations compare to your cash expectations. For example, intangibles, royalty rights and intellectual property are all now subject to valuation based on expected future cash returns.

- Consider outsourcing valuation work to external consultants, as a way of shifting some of the risk from your company.

- Document the information you provide to auditors and management.

Turn Fair Value into a Career Boost
Becoming engaged in the financial reporting process can be difficult if your treasury department has lean staffing, Rieger acknowledges. However, treasurers who do become more involved in this area can actually leverage fair value accounting into a positive for their careers, he says.

Those who can cast aside the historical role of the treasurer and take on a broader and more strategic and analytical focus are more likely to rise up the financial ranks, he says.

"We're seeing more and more treasurers promoted to CFO," Rieger notes. "I believe the reason is that treasurers, more so than controllers, are adopting this broader focus. Our AFP surveys are showing that treasurers increasingly are getting involved with financial reporting."

To learn more about fair value accounting and related FASB statements, visit www.fasb.org.