

Alert

December 2008

*“...mark-to-market is
accounting madness.”*

Ready, Value, Fight! Public Battles over Mark-to-Market

What exciting times in the world of valuation! Now just about every day another business section or magazine publishes strongly worded opinions in what has become a pitched battle over “Mark-to-Market.” Even our non-financial friends are familiar with the term “FAS 157.”

The last few months alone have seen Congress require a study on mark-to-market, and the FASB and the SEC feeling forced to issue quick statements. On Sept. 30th, the SEC and FASB issued a joint guidance on fair value, confirming (under pressure from the market in our opinion) that distressed or forced sales are not indicative of fair value. They conclude that “management estimates” may be more appropriate (i.e. financial models).

The public battles then accelerated, with counter-fire letters and press releases:

- Oct. 13 In an open letter to the SEC, the American Bankers Association requests the SEC override US accounting rules on mark-to-market.
- Oct. 15 A joint letter to the SEC from the Council of Institutional Investors, Center for Audit Quality, CFA Institute, and Consumers Federation of America states that suspension of fair value or mark-to-market accounting is “decidedly not in the public interest.” And “a move by the SEC to suspend fair value accounting would be a disservice to the capital markets, would be inconsistent with the views of investors, and would harm the credibility and independence of the standards setting process. Investors have a right to know the current value of an investment.”
- Oct. 27 Financial Accounting Foundation (overseer of FASB) issues letter to the SEC rejecting calls for legislation to overturn statement 157.
- Oct. 28 In a *Forbes* cover story, Steve Forbes says in the recent crisis “Mark-to-market became the weapon of mass destruction” and mark-to-market is “accounting madness.”
- Oct. 29 At the first SEC Roundtable on Mark-to-Market, William Isaac, former FDIC chairman, (“the most vociferous opponent” of fair value per FEI) states, “the FASB and the SEC should immediately withdraw SFAS 157.”
- Nov. 4 Stephen Schwarzman, CEO of The Blackstone Group, opines in a *Wall Street Journal* OpEd: “we need to abolish mark-to-market accounting.”

To us, much of this seems to come from not correctly understanding SFAS 157, and some personal interests coming to the fore. For instance, Issac, speaker at the first SEC Roundtable, said that true economic value equals discounted cash-flow analysis — which is a standard fair value model for Level 2 and 3 assets under FAS 157 — which he fully opposes.

continued on back...

“The challenges of valuation are real, and the battles are not over, but we believe FAS 157 is here to stay, and that investors and lenders will benefit.”

Ready, Value, Fight! Public Battles over Mark-to-Market

Mr. Isaac repeats his de facto (and contradictory) support for the SFAS 157 modeling of values by also saying: “If SFAS 157 is suspended, bank management, auditors, and regulators ... will consider the cash flows on the assets.” Similarly, in his 9/19 WSJ OpEd: “Regulators must evaluate the assets on the basis of their true economic value (a discounted cash-flow analysis).”

FAS 157 is guidance on **how** to determine fair value, it does not **require** any fair values.

NO RELIEF FROM THE SEC

On December 8th, (after the SEC’s second public roundtable) Chairman Cox of the SEC seems to try and close out the main argument, opining that FAS 157 is here to stay, stating that “Although the study is not complete, the current direction indicates a number of preliminary findings that I would like to share with you ...”

“First, for many financial institutions, investments marked-to-market through earnings on a quarterly basis represent a minority of their total investment portfolio.

“Second, most investors, and many others, agree that fair value is a meaningful and transparent measure of an investment for financial reporting purposes. Financial reporting is intended to meet the needs of investors.

“Third, accounting standards have served our capital markets well, but we must endeavor to continue to develop robust best practice guidance for auditors and preparers — particularly for fair value measurements of securities traded in inactive or illiquid markets.”

We have seen public auditors now coming to accept the fact that a market price (say for a company’s stock) is not the only indicator of value for that company. The challenges of valuation are real, and the battles are not over, but we believe FAS 157 is here to stay, and that investors and lenders will benefit. For more information contact your VRC representative or Raymond Weisner at 917-338-5617. **VR**

Editor: Theresa Miller © Valuation Research Corporation. All rights reserved.



www.valuationresearch.com

Boston	617.342.7366
Chicago	312.957.7500
Cincinnati	513.579.9100
Milwaukee	414.271.8662
New York	212.983.3370
Princeton	609.243.7000
San Francisco	415.277.1800
Tampa	813.463.8510

VRG Member Firms:

Argentina
Australia
Brazil
China
Mexico
Spain
United Kingdom
Venezuela