Congressionally-Mandated Study Says Improve, Do Not Suspend, Fair Value Accounting Standards

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Washington, D.C., Dec. 30, 2008 — The Securities and Exchange Commission today delivered a report to Congress mandated by the Emergency Economic Stabilization Act of 2008 that recommends against the suspension of fair value accounting standards. Rather, the 211-page report by the SEC's Office of the Chief Accountant and Division of Corporation Finance recommends improvements to existing practice, including reconsidering the accounting for impairments and the development of additional guidance for determining fair value of investments in inactive markets, including situations where market prices are not readily available.

Additional Materials

- SEC Report to Congress on Mark-to-Market Accounting

As mandated by the Act, the report addresses the following six key issues:

1. the effects of such accounting standards on a financial institution's balance sheet;
2. the impacts of such accounting on bank failures in 2008;
3. the impact of such standards on the quality of financial information available to investors;
4. the process used by the Financial Accounting Standards Board in developing accounting standards;
5. the advisability and feasibility of modifications to such standards; and
6. alternative accounting standards to those provided in such Statement Number 157.

Among key findings, the report notes that investors generally believe fair value accounting increases financial reporting transparency and facilitates better investment decision-making. The report also observes that fair value accounting did not appear to play a meaningful role in the bank failures that occurred in 2008. Rather, the report indicated that bank failures in the U.S. appeared to be the result of growing probable credit losses, concerns about asset quality, and in certain cases, eroding lender and investor confidence.

"The Office of the Chief Accountant and the Division of Corporation Finance, in consultation with the Department of the Treasury and the Federal Reserve, have produced a valuable study of many of the critical issues surrounding the use of fair value accounting in the extraordinary market conditions of the past year," said SEC Chairman Christopher Cox. "The study is the culmination of several months of extensive analysis, public roundtables and consultations with investor groups, accounting firms, banks, insurance companies, think tanks, and academics. It will be a useful source of information and guidance not only to policymakers in Congress but also to the independent standard-setters as they continue their work on these important issues. Deputy Chief Accountant James Kroeker, who directed the study, and the staff of the Office of the Chief Accountant and the Division of Corporation Finance deserve particular commendation for their work in producing this comprehensive study before the January 2 deadline set by Congress."

The Emergency Economic Stabilization Act of 2008 directed the SEC, in consultation with the Board of Governors of the Federal Reserve System and the Secretary of the Treasury, to study mark-to-market accounting standards as provided by the FASB Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*. The Act, which was signed into law on Oct. 3, required that the study be completed within 90 days.

While the report does not recommend suspending existing fair value standards, it makes eight recommendations to improve their application, including:

- Development of additional guidance and other tools for determining fair value when relevant market information is not available in illiquid or inactive markets, including consideration of the need for guidance to assist companies and auditors in addressing:
  - How to determine when markets become inactive and whether a transaction or group of transactions are forced or distressed
  - How the impact of a change in credit risk on the value of an asset or liability should be estimated
  - When should observable market information be supplemented with and/or reliance placed on unobservable information in the form of management estimates
  - How to confirm that assumptions utilized are those that would be used by market participants and not just a specific entity
- Enhancement of existing disclosure and presentation requirements related to the effect of fair value in the financial statements.
- Educational efforts, including those to reinforce the need for management judgment in the determination of fair value estimates.
- Examination by the FASB of the impact of liquidity in the measurement of fair value, including whether additional application and/or disclosure guidance is warranted.
- Assessment by the FASB of whether the incorporation of credit risk in the measurement of liabilities provides useful information to investors, including whether sufficient transparency is provided currently in practice.

The report also recommends that FASB reassess current impairment accounting models for financial instruments, including consideration of narrowing the number of models under U.S. GAAP. The report finds that under existing accounting requirements, information about impairments is calculated, recognized and reported on basis that often differs by asset type. The report recommends improvements, including: reducing the number of models utilized for determining and reporting impairments, considering whether the utility of information available to investors would be improved by providing additional information about whether current declines in value are consistent with management expectations of the underlying credit quality, and reconsidering current restrictions on the ability to record increases in value (when market prices recover).

In conducting the study, data was obtained and analyzed from a broad-based population that included a cross-section of financial institutions. In addition to empirical analysis, the SEC staff obtained valuable input from a broad cross section of market participants through a public comment letter process and by hosting a series of three public roundtables to obtain a wide range of views and perspective from all parties.

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http://www.sec.gov/news/press/2008/2008-307.htm
