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FASB Hesitates, SEC Stands Still on Fair Value

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By Joseph Rosta

The banking industry won a minor skirmish in the fair value war in January when the Financial Accounting Standards Board turned down a proposed amendment that would have expanded controversial fair value/mark-to-market practices in the financial sector.

The proposal would have required "interim and annual disclosures for all financial instruments" covered by FASB Statement 107 - including "debt securities classified as available-for-sale, debt securities classified as held-to-maturity, and loans and long-term receivables" year-end 2008. On January 30, the board instead issued a revised draft rule to step up footnote disclosures from an annual to a quarterly basis.

But the financial sector remains jittery over the prospect of expanding mark-to-market edicts, which could lead to losses that some observers fear might rival those already reported. Rules that would require such accounting have been in a state of suspension for months, while the debate about the efficacy of such practices continues.

FASB's decision to rethink the amendment to Statement 107 was welcomed by Frank Gonzalez, who heads the financial institutions practice in accounting firm MBAF's assurance services department. "It's important that in-depth or significant changes affecting financial reporting be more consistent," he says.

"That was the only decision they could make," according to Donna J. Fisher, svp/tax and accounting at the American Bankers Association. FASB issued the recommendation "very, very late in the year" and banks would not have enough time to set the necessary processes in place.

The ABA's position on fair value/mark-to-market accounting is clear: the method should only be used for companies with fair value business models. The practice should not be a blanket requirement. "Short term, [the] ABA has requested the repair of other than temporary impairment [OTTI], the definition of fair value, and accounting for business combinations," Fisher said. Longer term, the bankers want FASB to "stop writing any more rules requiring fair value."

Under U.S. GAAP, OTTIs are permanent. The ABA recommends that the FASB move to the international approach, where OTTI is based on credit risk. Fair value is a flawed practice because the "market can be very volatile and not necessarily reflect the economics of a transaction," Fisher says.

Not only is fair value/mark-to-market inefficient, according to Gonzalez, but "there are so many different methodologies. Bank A is not the same as Bank B - there's no consistency. It's like shooting in the dark."

The Securities and Exchange Commission earlier studied the issue, listened to debate, and did nothing. That was the result of a Congressionally mandated study on the subject. The commission found that "investors generally believe fair value accounting increases financial reporting transparency and facilitates better investment decision-making." The SEC also thinks mark-to-market processes did not play a "meaningful role" in 2008 bank failures.

SEC staffers did recommend fine-tuning of mark-to-market rules, including "development of additional guidance and other tools for determining fair value when relevant market information is not available in illiquid or inactive markets."

The SEC "acknowledged problems with measuring OTTI," Fisher observes, but "did not consider the impact of fair value accounting on market uncertainty."