



CAQ Alert #2009-01 – January 8, 2009

## DEAR CENTER MEMBERS

### SEC Report of Congressionally-Mandated Study Says “Improve, Do Not Suspend” Fair Value Accounting Standards

On December 30, 2008, the Securities and Exchange Commission (SEC or the Commission) reported the [results of the study](#) on mark-to-market accounting standards as mandated within Section 133 of the [Emergency Economic Stabilization Act of 2008](#) (EESA). The findings discovered during this study led to the recommendation that fair value accounting should not be suspended. Rather, the findings indicated a need for improvements to existing practice, which are discussed in more detail below. The results of the study were delivered by the Commission to Congress in a 211-page report ([Report](#)).

Enacted on October 3, 2008, the EESA 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 Financial Accounting Standards Board (FASB or the Board) [Statement of Financial Accounting Standards No. 157, Fair Value Measurements](#) (SFAS 157) and to report its findings to Congress within 90 days. Under the Act, the SEC was instructed to focus on six key issues, which are addressed in detail within the staff Report. The issues include: (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 FASB in developing accounting standards; (5) the advisability and feasibility of modifications to such standards; and (6) alternative accounting standards to those provided in such SFAS 157.

As a result of the study's focus on these six key issues, the SEC ultimately came to the recommendation that fair value accounting should not be suspended. The SEC's press release cited key findings leading to this recommendation, including the thought that “investors generally believe fair value accounting increases financial reporting transparency and facilitates better investment decision-making” and 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.”

Although the Report does recommend that fair value accounting not be suspended, there are eight recommendations identified within the Report for improvement to the application of fair value accounting. The recommendations include:

1. SFAS No. 157 should be improved, but not suspended
2. Existing fair value and mark-to market requirements should not be suspended
3. Additional measures should be taken to improve the application and practice related to existing fair value requirements (particularly as they relate to both Level 2 and Level 3 estimates) including:
  - Considering the need for additional application guidance or best practices for determining fair value in illiquid or inactive markets. The Report also states that the staff believes additional assistance in the form of guidance, education, and training is warranted in several areas and noted examples that include:
    - How to determine when markets become inactive
    - How to determine if a transaction or group of transactions is forced or distressed
    - How and when should illiquidity be considered in the valuation of an asset or liability
    - How should the impact of a change in credit risk on the value of an asset or liability 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 by a specific entity
  - Enhancing 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; and
  - Assessment by the FASB of whether the incorporation of a company's own credit risk in the measurement of liabilities provides decision-useful information to investors, including whether sufficient transparency is provided currently in practice.
4. The accounting for financial asset impairments should be readdressed
5. Implement further guidance to foster the use of sound judgment
6. Accounting standards should continue to be established to meet the needs of investors
7. Additional formal measures to address the operation of existing accounting standards in practice should be established
8. Address the need to simplify the accounting for investments in financial assets

The observations that led to these recommendations are outlined in detail in the SEC's Report.

In conclusion to the study, Chairman Cox stated that, "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."

The [SEC's Report](#) and [press release](#) can be accessed by referring to the respective links on the SEC's website.

#### **Other Related Resources for Auditors:**

- [CAQ Comment Letter](#) CAQ Comment Letter to FASB on Proposed Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20, December 30, 2008
- [CAQ Alert #2008-89](#) FASB Issues Proposed FSP 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue 99-20*, December 22, 2008
- [CAQ Alert #2008-88](#) CAQ Highlights of the 2nd SEC Roundtable on Fair Value, December 19, 2008
- [CAQ Alert #2008-79](#) CAQ Issues Comment Letter to SEC on Mark-to-Market Accounting Study, November 17, 2008
- [CAQ Alert #2008-78](#) CAQ Highlights of the 1st of 2 SEC Roundtables on Fair Value and FAF Letter to SEC, November 14, 2008
- [CAQ Comment Letter](#) CAQ Comment Letter to SEC on SEC's Study of "Mark-to-Market" Accounting, November 13, 2008
- [CAQ Alert #2008-72](#) IASB Activity Relative to Fair Value Accounting and Other, October 24, 2008
- [CAQ Alert #2008-66](#) SEC Expresses Views Regarding Assessment of Declines in Fair Value for Perpetual Preferred Securities Under Existing OTTI Model, October 15, 2008
- [CAQ Alert #2008-65](#) FASB Issues Final Guidance on Measuring Fair Value of Financial Assets in Inactive Markets, October 14, 2008
- [CAQ Comment Letter](#) CAQ Comment Letter to FASB on Proposed FASB Staff Position No. 157-d, "Determining the Fair Value of a Financial Asset in a Market That Is Not Active", October 8, 2008
- [CAQ Alert #2008-63](#) SEC Commences Work on a Study of Fair Value Mandated by Congress, October 8, 2008
- [CAQ Alert #2008-62](#) IASB Responds to Credit Crisis and FAF Responds to Suggestions that Congress Suspend Fair Value Accounting, October 6, 2008
- [CAQ Alert #2008-58](#) SEC and FASB Issue Clarifications on Fair Value Accounting, October 1, 2008

- [CAQ Alert #2008-55](#) CAQ Comments on Accounting Issues Related to Other-Than-Temporary Impairment of Investment Securities in Response to Issues Raised by the American Bankers Association, September 18, 2008
- [CAQ Alert #2008-53](#) SEC Issues Addendum to the SFAS 157 MD&A Letter Issued in March 2008, September 17, 2008
- [CAQ Alert #2008-18](#) SEC Issues Letter to Public Companies on MD&A Disclosure Regarding the Application of SFAS 157 (Fair Value Measurements), March 31, 2008
- [CAQ Alert #2007-64](#) PCAOB Issues Staff Audit Practice Alert on Auditing Fair Value, December 14, 2007
- [CAQ Alert #2007-51](#) CAQ Issues White Papers on Illiquidity in the Markets, October 3, 2007

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