

December 30, 2008

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Financial Accounting Standards Board  
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LETTER OF COMMENT NO. 244

Re: Proposed FSP EITF 99-20-a

Dear Mr. Golden:

I am writing in regard to the Proposed FSP EITF 99-20-a, "Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20." For the most part I support the amendment because I believe it will result in a fairer presentation of the value of the applicable beneficial interests as compared to an independent market driven valuation. The primary reason for this opinion is due to the fact that the current market for these securities is seriously flawed, potentially resulting in values that could be dramatically divergent from the truest current values of these assets, as derived from expected contractual cash flows. However, as consistent with traditional business valuation methodologies, the FSP should not require one methodology over the other; the fairest presentation would most likely be established from using both methodologies and deriving a reportable value from the applicable reconciliation. *In short, the market based valuation requirement should not be removed, but incorporated into the process that management and their applicable independent auditor or valuation expert use in establishing appropriate impairments.*

It is understood, given the significance of this FSP, the FASB could be faulted for the late presentation and lack of comment period timeliness of this proposed amendment. Nevertheless, any such fault is not significant when weighed against the adverse effects of allowing a failed market place to determine the values of these beneficial interests.

## Overview

At its core, EITF 99-20a, seeks to provide the owners/holders of securitized financial beneficial interests the ability to utilize SFAS 115 (cash flow) methodologies (as opposed to 99-20 which necessitates using external market factors) in valuing certain securitized beneficial interests. While the topic seems rather dry, the effects of such a change could allow thousands of financial services entities the ability to maintain equity levels considerably above what some would consider their true market values. The reason for this difference in equity is due to temporary market factors currently pointing to valuations of these beneficial interests in amounts dramatically below their values as indicated by actual and projected cash flows. EITF 99-20 would necessitate dramatic reductions in asset values thereby wiping out the capital of many of the holders or obligors of these securitized beneficial interests.

Under current unusual circumstances, I do not believe that external market factors should be the primary determinant of the value of these beneficial interests simply because in its present state, the market for these securities has become dysfunctional and/or dislocated. Unless these securities are being held for sale, the best determinant of value has to be the current and best estimate of future cash flows ( SFAS 115). In this respect, I agree with the FSP proposal. In the present circumstances, any valuation employed by management, and assented to by their independent auditors must primarily take into account actual and projected cash flows. Where I disagree, however, with the FSP proposal is in the seeming elimination of 99.20 market principles. It cannot simply be that cash flows alone should be relied upon as the value determinant. External market force valuation indicators should also be considered. The use of multiple sources of information for establishment of fair value is an established concept. The reconciliation of one source to another has long been used to rationalize any predictor of value, or in this case the extent of impairment.

Any amendment to EITF 99.20 should be to require the holders of these beneficial interests to use both methodologies in valuing these securities, together with a best effort at reconciling the two methodologies. The holders would then select the valuation between these two methodologies that they believe best represents the fairest or most truthful presentation of these securities. Information about these reconciliations should be presented in any associated financial statements. At a minimum, this option should be provided to financial statement preparers.

## Further Analysis

### A Dysfunctional Market

It would be a mistake for supporters of fair value accounting to use this particular market circumstance as their beachhead in advancing the cause of the “market is always right” theories. Yes, the market is mostly always right. But history is full of examples where it was not. Full information and robust participation are the keys to a healthy market. Any efforts to introduce “fair value” throughout financial reporting must contain methodologies for ascertaining the health of the applicable market. In this case both of these keys are not present. At present, the only reliable source for valuing these beneficial interests is their inherent and collectible cash flow. This market in particular has little or no buyers. It also has insufficient knowledge of the value of these securities because common market markers such as debt ratings have proved to be unreliable. As a result, cash flow experiences represent the only tangible and reliable source for fairly assessing the value of these securities. In addition, the only buyers in this market seem to be bargain hunters, looking for extraordinary returns. In addition, given the nature of these assets, (that they are securitized and offer multiple opportunities for repayment<sup>1</sup>), and the current

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<sup>1</sup> Multiple sources for collection of these contractual obligations can include not just the originators of the underlying debts but other real sources such as external guarantees, related third parties, sales of other assets, etc. In general the market dismisses these alternative sources for repayment but history tells us that they are very real. Consider, for example that the RTC eventually made money taking over and selling assets at a later date.

nature of these markets, one cannot look to “point in time” independent market forces to establish reliable fair values.

*As a result of this failed market, utilizing traditional market valuation models in any such circumstance could lead to materially incorrect presentations of the true values of these securities on thousands of balance sheets. In addition, securitized beneficial interests contain within them, multiple sources of cash payments and principal repayments that may not be captured in many market models, particularly those models that have been designed to work in healthy markets.*

## **Complexity in Fair Value Assessments**

When dealing with issues of “fair value”, many inherent complexities exist. One size does not fit all. In fact one size rarely fits more than a small a few. Employing principles inherent in establishing “fair value” means considering factors such the nature of the asset, state of the applicable market, user requirements, contractual issues, decision making options, intangible asset implications, the value of guarantees and securitizations, and changing risk profiles. As related to transactions, these factors in turn need to be considered in association with issues of ownership, risk transfer, management intent, unusual market activity, economic conditions or credit worthiness. By its nature, fair value assessments, are the products of many areas of judgment. If the FASB, IASB, SEC or any other authoritative body wishes to require the presentation of “fair value” concepts, it must accept the idea that entities subjected to those requirements have to be able to employ processes and or judgments that may not be either consistent intra-organizationally and/or among peers. What is important is establishing and presenting the best and fairest disclosure of the applicable assets or beneficial interests. While there should only be one definition of “fair value”, there have to be many methodologies available for reaching any “fair value” assessment. If presenting the “fairest” disclosure were to require utilizing SFAS 115, EITF 99-20 or something completely different, then an entity ought to be able to do so – provided they can aptly justify the approach. The primary goal of standard setting should not be to achieve consistency as presented in 99-20-a or eliminate possible methodologies, but to achieve a “fairer” manifestation of the applicable economic circumstances to the various investor or stakeholder constituencies. Such judgment, for example should include more than one presentation of the same information.

## **Considerations of Management Bias**

Based on some of our research at Audit Analytics, it seems clear that management bias exists in financial statement preparation and reporting. Our review of over 8,000 financial restatements over the past eight years highlights that restatements that would have adversely affected previous financial statements (as opposed to improving them) make up the vast majority of all restatements (almost 90%). In theory, these two circumstances should have occurred in roughly equal numbers. The implications of this information should be clear. Comment writers that object to the FSP on the basis that they are concerned that SFAS 115 leaves too much judgment to internal financial management and thereby could result in over valuations of these securitized

beneficial interests, have a right to be concerned. And given the current financial crisis engulfing some of the holders of these securities, one might be doubly concerned. And yet, while this concern should be of interest to Audit Committee members, management, the SEC and independent auditors, it should not be considered in standards setting issues like this one. It is the FASB's role to put forward the guidelines that will result in the "best and fairest" presentations of economic circumstances to the greatest number of recipients. I don't believe that the issue of management bias should be considered in this circumstance.

Sincerely,

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