

I appreciate the opportunity to comment on the Exposure Draft of the Proposed Statement of Financial Accounting Standards – Going Concern; File reference No. 1650-100. My comments are included in the following paragraphs.

I am troubled with the relationship between any definition of going concern and the provisions of SFAS 157 and SFAS 159 which allow for the revaluation of a firm's liabilities. Under these pronouncements, a company may re-value its liabilities to market value – below book value – and recognize a gain and a resulting increase in shareholders' equity.

If the FASB is moving toward financial statements that are strictly a theoretical construct, then the ability to revalue liabilities could make sense. But the concept of going concern is important because it removes financial statements from the theoretical realm and places them in the context of a real firm with real creditors and addresses a firm's ability to continue to function; an important part of that being the ability to repay its debts. At one level the FASB has created a contradiction within the standards themselves – management may re-value liabilities and imply a loss to creditors, yet not be required to disclose doubts about the company's ability to continue as a going concern. Outside of a purely theoretical framework, how could management not make a going concern disclosure if it recognizes that the value of its liabilities are worth less than what the firm is obligated to pay? When issuing financial statements without a going concern disclosure, are not management and the auditors making a statement that all liabilities are expected to be satisfied in full in the ordinary course of business? We may assume that "market participants" would buy and sell a company's debt obligations in a hypothetical secondary market at something other than face value. But the going concern concept places the responsibility squarely on management's shoulders to state their expectation, not the theoretical expectation of "market participants" in a hypothetical secondary market.

More damaging, in my view, is the contradiction that the FASB has created between accounting standards and long-established legal precedent. The idea of "absolute priority" is firmly established in bankruptcy law, which is properly considered in connection with the Going Concern exposure draft. According to Black's Law Dictionary, the absolute priority rule is:

"The rule that a confirmable reorganization plan must provide for full payment to a class of dissenting unsecured creditors before a junior class of claimants will be allowed to receive or retain anything under the plan."

So while legal precedent would dictate that debt-holders be made whole before equity-holders receive anything, SFAS 157 & 159 allow a loss to creditors with the result being a gain to equity. This could only happen in a theoretical sense. Long-standing legal precedent would preclude such a result in the real world.

At a minimum, the ability to revalue liabilities and recognize a gain should be precluded within the context of a firm that is expected to continue as a going concern. Real world experience would dictate that this cannot happen. Perhaps it would be useful to allow management to revalue liabilities when there is a doubt that the firm can continue as a going concern, but it should not under any circumstance result in a gain to equity holders. An offsetting reduction in the value of assets would seem to be most appropriate in that circumstance.

Thank you for the opportunity to comment. Feel free to contact me if you have any questions about my comment letter.

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