



LETTER OF COMMENT NO.

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Financial Crisis Advisory Group
Financial Accounting Standards Board
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To the Financial Crisis Advisory Group:

Thank you for the opportunity to comment on the important work of the Financial Crisis Advisory Group (FCAG).

As I understand it, one of the major goals of the FCAG is to consider and provide recommendations regarding the standard-setting implications of the global financial crisis. I'd like to address that in light of my experience working with companies, boards, bankers and sophisticated investment managers and my particular experience and expertise with regard to analyzing the economics of financial institutions.

Regarding the questions raised, here is some context which may be helpful to FCAG in developing recommendations.

1. In the US certainly, earnings statements receive an over-weighted emphasis by internal managements in running their businesses. They also receive an over-weighted emphasis by sophisticated investors, traders, and bankers.
For example:
 - a. Even internally inside firms, not only at the top but at divisional levels, CEOs and boards, reinforced by financial consultants, can believe that a change in the accounting represents a change in economics (and I've witnessed a sale of a business on that basis alone).
 - b. Even investment managers of billion dollar funds have difficulty sorting out the economics of major institutions – and over-rely on earnings statements.
 - c. *Despite no change in economics of the business*, because of the over emphasis on earnings statements by banks, credit markets can be impacted by accounting changes as companies can be in violation of bank covenants simply *because of* accounting changes.
2. As a result of the over-emphasis on earnings, *despite no change in economics of the business*, market prices for equity securities often change when accounting changes are made. The implication of this is important for a number of reasons.
 - a. Because market price changes may have no relationship to the economics of the underlying security, "fair value" (which I will put in quotes because the title itself suggests something that I think it is unfair to expect accounting standard setting to address) is mislabeled and suggests that the result is more than it is or can be.
 - b. Since market prices change despite no change in economics, then using market prices in earnings statements should be approached very cautiously because market values, while they may be good measures of current liquidation/trading values, they may not represent longer term economic values as well.
3. Financial services firms' statements are easy to manipulate and provide other distortions. Not only are provisions easy to manipulate, so too are earnings easy to manipulate by disposal of assets. Sales of traded securities is one example. Another one, fundamental to business operations, is the move away from "acquire and hold loans" to "securitize and sell". Despite the negative impact on long run economics,

from experience I can say that bankers were seduced to move toward “securitize and sell” leading up to this crisis because of the boost provided to short term earnings. Banks became traders because the earnings statements provided an incentive to do so. In that way, more broadly, accounting statements had an impact in fueling non-economic outcomes.

- a. For example, one major institution I analyzed a few years ago tanked its earnings in the first year of a new CEO by cutting back on securitizations. Gradually after that, the major firm re-introduced securitization and increased its level of securitization each year thereafter which increased earnings year on year. This was something that most if not all sophisticated investors missed. **Better line item disclosure would be helpful.**
- b. Off-balance sheet items confuse and confound managements, boards, investors and others. **Items should not be off balance sheet if there is economic recourse/liability.** (Substance in accounting reporting should trump form.)
- c. In addition, reporting around trading activities is currently inadequate in terms of emphasizing risk exposures, particularly on derivative and hedging books. While shown on the books on a net basis where they may appear a minor part of the business, these books may at some firms represent over \$1 trillion in outstanding contracts and represent real risk in a time of crisis. **More disclosure should be required.**

As a result of the above, my other recommendations would be:

1. A **move by standard setters away from one major statement** on which management, boards, investors and creditors overly depend.
 - a. One statement (that of the going concern) should show market values only for assets to be liquidated near term (i.e. available for sale). A firm’s liabilities which are not readily saleable or intended for resale would not be marked.
 - b. If investors demand it, another statement should be provided with market values on a traded/liquidation basis.
 - c. If management would like to provide it, they should provide a statement with their estimates of the long run economic values (of assets and/or liabilities).
2. Because provisions are manipulated (my book, Economic Value Management, part of the Wiley finance series, shows how one bank even raised and lowered its provisions each quarter to achieve a very interesting effect), and because, in substance, the allowance for credit losses is simply nothing more than an equity carve-out, regarding question two, I would **recommend any additional allowance be included either as an equity carve out (choice 3) or in a footnote (choice 4).**
3. Because of the above, I believe **standard setters should not act in crisis mode at all.** I think that the impact of accounting is *more* than it should be. (And the impact of true changes in businesses, often too little.) Thus standard setters should approach changes to accounting standards, especially those that impact the over-emphasized statements, with caution and actively reach out to more diverse groups for input before proceeding.

If you have any questions or I can be of help, please let me know (614-571-7020 or ebloxham@thevaluealliance.com).

Thank you again for the opportunity to comment.

With best regards,
Eleanor Bloxham
CEO, The Value Alliance and Corporate Governance Alliance