



LETTER OF COMMENT NO. 256

**To:** Adrian Mihis; Diane Inzario; Joseph Verruccio; Kristofer Anderson; Mark Trench; Meghan Clark; Peter Proestakes; Russell Golden; Vita Martin; Wade Fanning

**Subject:** FW: Proposed FSP FAS 157-e

**From:** nbrex@optonline.net [mailto:nbrex@optonline.net]

**Sent:** Wednesday, April 01, 2009 12:19 AM

**To:** Director - FASB

**Subject:** Proposed FSP FAS 157-e

The fact that FASB is revisiting fair value measurement yet again indicates that just tweaking it is not going to fix a fundamentally flawed accounting rule, thus the proposed changes are insufficient to correct the problem of fair value accounting. Thus, let's review the fundamental failures of fair value measurement.

Fair value accounting measures the performance of markets, it doesn't measure the performance of a company. Thus, it is a complete failure of one of the fundamental tenets of accounting—helping those with capital make decisions about where to put that capital. Currently, those with capital are not supplying it to those who need capital at any price because of the performance of the markets, not the performance of the company.

If those who are making accounting rules would take just a few minutes and look at what is happening in the world, they would quickly realize no one is putting capital at risk anywhere. Markets have not seen the volatilities nor the declines of the magnitudes experienced subsequent to the adoption of fair value accounting since the Great Depression. If we are to judge fair value accounting by the certainty it was supposed to give the marketplace, then we must conclude it has been a complete failure because the market volatility is implying more uncertainty, not less.

Those who are mandating fair value accounting need to take a visit to the marketplace to see how those who are interested in purchasing the illiquid assets are valuing them. Take a trip to any firm that is gearing up to purchase these "toxic" assets. These firms will spend hours going through the details of the models they have created. One firm I visited showed me a model with over a half million lines of code! Now, for some reason, the accountants and the accounting rules are mandating that publicly traded companies value these securities based on transaction prices, when those who are transacting are valuing the securities with models. Of course, they mark the securities to market once they have purchased them, but they only buy them after their model has given them enough comfort that they can purchase them with a margin of safety that still gives them a 20% unlevered yield-to-maturity.

In other words, the firms that want to buy the securities value them thus:

Buyer of security: Market price + margin of safety + transaction costs + 20% unlevered yield-to-maturity = Present Value of Security = Pessimistic scenario model price

In the meantime, accounting rules tell the publicly traded companies that the value of their securities is just the market price:

Owner of security:  $\text{Market price} = \text{Present Value of Security}$

Someone needs to clue in the accountants and those who set the accounting rules that there is a huge disconnect in the equations, unfairly biased against the owner of the security. For some reason, the buyers of the security are allowed to use their most pessimistic scenario computer model, but those who already own the security are not. Further, the margin of safety increases as market volatility increases, which only serves to decrease the value to the asset owner relative to the asset purchaser. Until fair value measurement takes into account this asymmetry between owner and purchaser, the accounting rule will continue to be a failure.

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