



LETTER OF COMMENT NO. /

**Subject:** FW: File Reference Proposed FSP FAS 157-f

**From:** Ron DiMattia [mailto:ron@corporatevaluepartners.com]

**Sent:** Thursday, May 14, 2009 10:57 AM

**To:** Director - FASB

**Subject:** File Reference Proposed FSP FAS 157-f

I appreciate this opportunity to comment on FSP FAS 157-f and have included my response in the following paragraphs. I have commented on the measurement of liabilities in other responses to FASB staff.

FSP FAS 157-f is troubling from a number of perspectives, and is not likely to improve financial reporting. Most troubling is that it does appear that the FASB is moving toward financial statements that are strictly a theoretical construct, which is reinforced by the contents of FSP FAS 157-f. In it, the FASB acknowledges that "liabilities are rarely transferred in the marketplace because of contractual restrictions preventing the transfer of liabilities." Yet it requires preparers to still assume an orderly transaction in the measurement of a liability that is contractually restricted from transfer. The logic is oddly circular, and places preparers in a highly theoretical realm. Contractual restrictions exist for a reason in the real world, and if a company honors its contracts it will not transfer the liability. A company is obligated to pay the full amount of the liability, and if it does not an established legal process exists to ensure fair treatment to all parties. As a result, by following FSP FAS 157-f preparers are very likely to misrepresent the true financial condition of their company. It would seem to me that the principles of conservatism and objectivity would preclude such accounting treatment.

Given the guidance in FSP FAS 157-f, and other statements issued by the FASB, it would seem to be more accurate if financial statements were re-titled as, "Hypothetical Balance Sheet," "Statement of Hypothetical Income," and "Notes to Hypothetical Financial Statements."

I have included my prior comments below (with additional comments added for recent events):

**Conflict with Going Concern and Legal Precedent:** SFAS 157 conflicts with long-established accounting theory related to "going concern" because it allows a company to 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 re-value 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 whether these debts will be paid in full. If so the financial statements should reflect management's expectation, not the theoretical expectation of "market participants" in a hypothetical secondary market.

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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 concept of going concern. 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 allows 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.

*{Update – Recent developments in the Chrysler bankruptcy could negate my comments about absolute priority. It would appear at this point that unsecured creditors of Chrysler have been excused from the absolute priority rule, to the detriment of secured creditors. It does not appear that the exception extends to shareholders also, but the case is ongoing as I write this letter. The final resolution of the Chrysler bankruptcy could affect long-standing legal and economic precedent}.*

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.

***The conflict between SFAS 157 and the going concern concept is the thread that unravels the fabric of fair value accounting (as it is currently written). If management's expectations must, by definition, predominate in the measurement of liabilities, then why shouldn't management's expectations predominate in the measurement of assets? Many assets (particularly intangible assets) have utility and value only as a result of management's plans and stewardship. Without an effective management team implementing useful plans, the value of many assets would evaporate (as demonstrated by numerous bankrupt companies). A sole reliance on the theoretical construct of "market participants" removes the critical element of value for many assets – management's expectations and plans; which are in every way as relevant to consider in valuation as are the theoretical expectations and plans of a hypothetical group of market participants.***

Thank you for considering this letter. I appreciate the opportunity to comment on FSP FAS 157-f.

Sincerely,

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