

To the Financial Accounting Standards Board

LETTER OF COMMENT NO 22/

Proposed FASB Staff Position FSP FAS 157-e

Submitted to "director@FASB.org" with subject line "File Reference: Proposed FSP FAS 157-e"

It has been quite some time since I have filed comments with the Board. The next-to-last time that I recall was when the Board was considering accounting for pensions, and I commented to the effect that the Board was doing something directly contrary to FASB 5, so I hoped the Board would explicitly state that it was doing so, in order to establish that this was going to be the way pension accounting was to be done. I believe that I also commented that the proposal was internally inconsistent, and gave specific examples. In any event, the matter was withdrawn, the Board worked on the topic some more, and eventually the Board issued a statement.

I also commented on another proposal (or exposure draft) to the effect that the Board seemed to be assuming that owners either run the company or else are merely outside investors. I pointed out that some investors work for the company, and do not run the company, but have particular interests related to their roles as part owners. The Board issued a document which referred to "nonmanaging owners."

I believe that the Board should not have issued Statement Number 157 on Fair Value Measurements in the first place, and therefore that attempting to modify it somewhat is simply not what ought to be done. When the Board took up the topic which resulted in FASB 157, I contacted the Board and informed the Board of the existence and implications of an academic paper which solved "the allocation problem," concerning whether companies should or should not allocate costs within the company. The position of two American Accounting Association monographs (one of which won the Notable Contribution to Accounting Literature Award in 1970), was that companies should not allocate costs. In an article in *Journal of Accountancy* in 1975, the author of the monographs took the position that even if companies wanted to allocate costs within the company, the Board should prohibit them from doing so.

I alerted the Board to the existence of an article which solved the allocation problem, demonstrating that companies must allocate costs if they are to survive. Why must they allocate costs? If they do not allocate costs, they use inputs inefficiently, become high-cost producers, and get competed out of existence. As a result of solving that problem, it became obvious that using market values in the financial statements and taking holding gains and losses into income would actually be harmful, because it moves companies away from efficient production of their output.

That paper had not yet been published, and I asked that the Board contact the editor of *The Accounting Review* about possibly getting that journal to publish the paper so that it would attract the most attention from academics, and if there were any incorrect elements in the paper, they would be pointed out. I never heard back from the Board, and *The Accounting Review* has published only failures to solve the allocation problem, not the solution (even though the solution was submitted).

I revised that article so it would be suitable for a different journal. I refer you to "Why Oil Companies Allocate Costs: A Primer," published in *Oil, Gas & Energy Quarterly*, September 2004, Volume 53, Number 1, pages 23-43.

Now I have a forthcoming article in *International Journal of Critical Accounting*. The article, concerning the economics of fair value accounting, deals with some of the bad effects of FASB Statement 157, Fair Value Measurements, which requires what is popularly being called mark-to-market accounting, mark-to-model accounting, fair value accounting, and other names. (An earlier version of the paper is presently available on the Internet-based Social Science Research Network at www.ssrn.com.) (Full disclosure: I submitted the article for consideration for publication in a special issue of *European Accounting Review* dealing with measurement issues in financial reporting, but Katherine Schipper [who I believe was a Board member while what became FASB Statement 157 was being considered] was one of two people making the decision to turn down the article for that special issue.)

You probably need some way to determine whether an individual who comments from out of the blue has any smarts concerning the topic under discussion.

- 1. You are welcome to read the American Accounting Association's monograph Statement on Accounting Theory and Theory Acceptance, which presents the position that the allocation problem is an example of a problem that cannot be solved.
- 2. You are welcome to read the solution of the allocation problem, using a mathematical proof, which was published in *Oil, Gas & Energy Quarterly*.
- 3. You are welcome to read the literature on a capital-markets phenomenon known as post-earnings-announcement drift, which could not occur if either the capital asset pricing model is exactly correct or if the efficient market hypothesis is exactly correct.
- 4. You are welcome to read the two versions of my paper posted on SSRN which address not only post-earnings-announcement drift, but also another capital-market anomaly concerning price rises after stock splits. (Full disclosure: *The Accounting Review* rejected that article also, although in November 2008 *The Accounting Review* did publish an article which disclosed that people who use discount brokerages, which did not exist until after brokerage commissions were deregulated on May 1, 1975, are not what cause post-earnings-announcement drift. The drift was reported in 1968 to have occurred in a sample from the 1950's to the 1960's. In other words, something which did not exist until at least the 1970's is not what caused something in the 1950's.)

My personal feeling is that the Board is trying to fix a lawnmower when what really needs to happen is for the Board to realize that the lawnmower is not the right work tool for use when cutting and styling patrons' hair in barbershops and hair salons. I believe the Board needs to rescind the general application of FASB Statement 157 and restrict its use to only those instances in which it is clearly appropriate. In other cases, parenthetic disclosure, as mentioned in the forthcoming article in *International Journal of Critical Accounting*, may well be sufficient, and even preferable. It is use of fair value in the financial statements together with recognition of holding gains and losses which is the problem. I am not objecting to the goal of determining fair value so that it can be disclosed parenthetically, nor to write-downs which recognize a permanent diminution of value of an asset.

Thank you.

submitted by Dr. Michael M. Grayson, a member of the faculty at Texas A&M International University in Laredo, Texas

Dr. Grayson has an earned doctorate in business administration, with a concentration in accounting (short terminology: a doctorate in accounting), earned from a university which was and remains accredited by AACSB, and which also has separate AACSB accounting accreditation. Dr. Grayson is licensed in at least one state to practice as a certified public accountant.

Dr. Grayson's submission is his own, and should not be considered in any way to be a position of his employer university.