



Fair value, mark-to-market at the center of heated debate

Seldom has a change in accounting law spawned a fight from the board rooms of industry to the op-ed pages of newspapers and trade publications.

But the changes in corporate accounting known as Fair Value Accounting and mark-to-market have ignited a firestorm of debate among bankers, developers, business leaders, CPAs and auditors, about the impact of these rules on companies and financial institutions left reeling from the fallout of the real estate sector and the collapse of the capital market.

The rule changes, developed over 30 years to protect investors from malfeasance, were designed to promote transparency for investors and to bring the U.S. standards in line with the international community. Some charge that the rule changes, which require companies and banks to use current market factors to assign value to real assets and financial instruments, such as securities, if they were sold or resolved as a liability, have tied an anchor to a sinking economy.

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are considering expanding fair value accounting to require companies to measure loan losses earlier, instead of when management is reasonably certain a loss will occur.

Transparency

Investor transparency is needed as much today, in a treacherous market, as ever, auditors and accountants argue.

Bill Peard, management partner of audit and enterprise risk services for Deloitte LLP, said fair value principles give investors the total view of the company's performance. Past measurements of the value of certain assets are no longer relevant.

"If you know assets aren't worth their cost and they don't have a trade value, what do you use?" he asked.

"Accounting is supposed to reflect business activity, not cause businesses activity," Peard said. "It's like blaming the scorekeeper for losing the game."

Fair value accounting has been evolving in this country for three decades. In 2006, FASB approved Rule 157, which sought to give clearer guidance to fair value principles. It went into effect in 2008.

Three years ago, when the rule was approved, and the economy was roaring along, few could have imagined the collapse of the housing market, which precipitated the fall of the credit market and the shock wave that has felled companies and shuttered banks nationwide.

Pricing real assets and financial instruments at fair values during the boom times really wasn't necessarily seen as a bad thing. Values were good, perhaps inflated. But as the economy has turned, and the real estate market has collapsed, companies are now forced to value assets at fire sale prices because of a lack of trade on rudderless markets. And many have taken huge write-downs, also known as paper losses or impairments, because the values of assets not intending to be sold have plummeted.

Impact

Richard Bowers, president and CEO of Richard Bowers & Co., is in the camp staunchly against fair value accounting in the current economic environment.

Bowers, whose company is the largest independent commercial real estate firm in Atlanta, said fair value accounting on real assets and mark-to-market of securities has worsened the effects of the housing collapse by creating an artificially inflated liquidity crunch among the nation's lenders.

"The housing downturn did not have to destroy every segment of the economy," Bowers said.

The federal government, Bowers insisted, wanted the housing sector to boom, and when it burst, the resulting accounting principles that were enacted were an overreaction.

Banks, fearful of their own liquidity position and the need to backstop rising loan problems, aren't lending. And problems get worse, Bowers said.

Developers with good assets can't find buyers because of the credit crunch, which exacerbates the problem.

Joe Brannen, president of the Georgia Bankers Association, agrees that mark-to-market works for securities. But a "500-year flood" for real estate has been worsened by accounting changes and it's having an effect on developers.

Take a developer in good standing with a bank that holds a \$100 million loan, with \$20 million cash and \$80 million in real estate collateral. If that developer needs to extend, and the reappraisal of the property determines it has been cut in half, the wild swing in loan to value would force the customer to provide a massive infusion of cash or collateral.

"You basically just put a customer out of business because of a paper attribute of an accounting rule," Brannen said.