LUNDS UNIVERSITET

School of Economics
Department of Business Administrations

Financial Crisis and the Fair Value Debate

Sejla Alijagic
Magnus Håkansson
Jignasa Patel

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Supervisors: Anne Loft and Niklas Sandell

ABSTRACT

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Authors: Sejla Alijagic,
Magnus Håkansson,
Jignasa Patel

Advisor/s: Anne Loft
Niklas Sandell

Five key words: Fair Value,
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Purpose: Using a case study of comment letters, our purpose is to examine the debate about fair value in accounting which has arisen in the context of the current financial crisis.

Methodology: We followed a rather qualitative approach while developing a flow chart in order to categorize and analyze our empirical material.

Empirical foundation: Case Study through Analysis of Comment Letters

Conclusion: The major conclusion that can be drawn from the study is that there is no strong relationship between the main groups and the opinion groups. The different views rather depend on specific industries. All the different opinion groups share the main view that fair value accounting needs improvements and major changes. These views and the expert debate can easily be looked at as a way to add to the already existing political pressures.

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ABBREVIATIONS

FSF	Financial Stability Forum
FASB	Financial Accounting Standards Board
FCAG	Financial Crisis Advisory Group
FSPs	FASB Staff Positions
FV	Fair Value
G20	Group of 19 world's largest national economies + EU
GAAP	Generally Accepted Accounting Principles
IAS 40	International Accounting Standard 40: *Investment Property*
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
SEC	U.S. Securities and Exchange Commission
SFAS 157	Statement of Financial Accounting Standard 157: *Fair Value Measurements*
SPV	Special Purpose Vehicle
US GAAP	U.S. Generally Accepted Accounting Principles

1. INTRODUCTION

This Chapter presents the problem area which will be discussed in this thesis. It introduces a review of the background and problem area followed by a purpose.

1.1 Background

World leaders gathered in London at the G-20 Leaders' Summit on Financial Markets and the Word Economy, on April 2, 2009, to address the recent global financial crisis, which has been the worst crisis in generations since the Great Depression.

Although there are many factors that led to the global financial crisis, experts point out three particular interrelated causes: 1) Rapid growth and subsequent collapse of U.S. house prices; 2) a general decline in mortgage underwriting standards, reflected in a growing proportion of home purchases financed by nonprime mortgages; and 3) widespread mismanagement of financial risks by firms engaged in mortgages, mortgage-backed securities, derivative financial instruments, and in particular the confusion behind Fair Value accounting. (Bullard, 2008)

Thus, the discussion on the financial crisis is of particular importance to the banking industry. Changes in market value of securities have had a tremendous impact on financial statements. The complexity of the particular instruments made it hard to get insight into the underlying financial data. As a result, the markets seized and the panic contributed to the active trading in many instruments to almost stop. During this time some of the most prestigious financial institutions in the world started to declare enormous write-downs.

The global financial crisis can be traced back to the ultimate starting point to an exceedingly indebted US economy. The crisis originated in 2006 due to the collapse in the real estate market, where failure was caused by the misapplication of risk controls for bad debts. Subprime mortgage loans which are granted to borrowers with a low credit or income, became apparent in 2007 as mortgage delinquencies and foreclosures dramatically began to rise in the US.

Banks as well as other financial institutions began to experience enormous amount of losses on residential mortgage and mortgage-backed securities. Towards the end of 2007, investors were less willing to bear credit risks and the loss of confidence in banks and other financial institutions increased. At that point banks intensified their lending standards, which reduced the accessibility to loans. As investors withheld to the safety of government bonds and other low-risk securities, the market gave up on risky debt securities relative to yields on U.S Treasury securities. Investors' concerns intensified during 2008 as financial losses continued to rise.

The below table shows a timeline of events of the Financial Crisis during 2007-2009

Timeline of Financial Crisis 2007-2009	
Date	**Events**
2007	
Feb-March	U.S. subprime industry collapse; several subprime lenders declaring bankruptcy, announcing significant losses, or putting themselves up for sale.
April	New Century Financial, largest U.S subprime lender, files for chapter 11 bankruptcy.
June	Merrill Lynch seized $800 million in assets from two Bear Stearns hedge funds that were involved in securities backed by subprime loans.
August	Worldwide "credit crunch" as subprime mortgage backed securities are discovered in portfolios of banks and hedge funds around the world.
October	Merrill Lynch announces a US$5.5 billion loss as a consequence of the subprime crisis, which is revised to $8.4 billion on October 24.
2008	
March	Collapse of Bear Sterns
June	Ex-Bear Stearns fund managers arrested by FBI Ex-Bear Stearns fund managers arrested by the FBI for their allegedly fraudulent role in the subprime mortgage collapse.
July	Major banks and financial institutions report loses approximately $435 billion
September	Global financial crisis: Emergency Economic Stabilization Act of 2008, Troubled Assets Relief Program, Bankruptcy of Lehman Brothers, Feds take over Fannie Mae and Freddi Mac, etc.
November	G7 meet to address the global financial crisis
2009	
January	Lawmakers propose massive bailout of U.S banks
Feb - March	JP Morgan Chase and Citigroup announce temporary moratorium n residential foreclosures.
March	US FDIC, Federal Reserve and Treasury Dept. Announce Public-Private Investment Program to leverage $75-$100 billion of TARP funds with private capital to purchase $500 billion of Legacy Assets (a.k.a. Toxic assets.
April	G20 meet in London to address the global financial crisis

In March 2008, the collapse of Bear Sterns Companies Inc., one of the largest global investment banks and securities trading and brokerage firms, led the financial community into uncertainty of what were to follow. Specifically, the uncertainty lay in the valuation of the mortgage-backed financial instruments, which were vital to the subprime mortgage crisis. In September 2008, the Emergency Economic Stabilization Act of 2008, also referred to as the bailout of U.S. financial system was released. Bad assets, especially mortgage-backed securities were purchased. The Act was released to reduce uncertainty regarding the value of the remaining assets and to restore confidence in the credit markets. In March 2008, Lehman brothers, a global financial services fund filed bankruptcy as they were faced with huge losses in lower-rated mortgage-backed securities during the continuing subprime mortgage crisis.

In February 2009, JP Morgan Chase, one of the leaders in financial services and Citigroup announced a temporary ban on residential foreclosures in light of the financial crisis. More recently, in March 2009, the U.S. Federal Reserve and the Treasury Department announced the Public-Private Investment Program to leverage $75-$100 billion of funds with private capital to purchase $500 billion of Legacy Assets (Toxic assets).

Default rates on subprime mortgage are not the only fault of rigorousness of the crisis. To a certain extent, high risk and low-quality mortgage acted as an accelerant to the extremity that spread through the entire economic system and became responsive as a result of several factors that are unique to this crisis. One of these factors is the application of fair value accounting.

Due to the instability in the market, financial institutions were faced with having to raise more capital. As time passed, the credit markets froze, the stock market declined even more and the investors reacted by looking for someone or something to blame. As the subprime market declined, firms reported losses related to the decrease in the fair value of assets, thus fair value accounting quickly emerged as a problem. Attempts are continuously made to blame accounting standards, rather than other possible factor such as the following:

- Borrowers who sought credit beyond their reach.
- Originators who wrote subprime mortgages to collect fees.
- Investment bankers who earned fees for bundling and selling vaporous bonds without adequately disclosing risk.
- Institutional investors who sought high returns without understanding the risk and real value.

1.1.1 The start of the crisis - Subprime Mortgage

The last few years have showed a dramatic growth in the global capital market and the global economy has gained new peaks within the industrial markets. Like never before, consumers devoured and company revenues showed an all-time high record. Furthermore, consumers had engaged themselves in mortgage loans. While the economy seemed to be growing by showing attractive housing prices, a disturbing situation occurred – the subprime mortgage crisis. Sub-mortgage loans have been the recent cause of the dramatic increase of delinquency and default in the United States.

A subprime mortgage is a type of loan granted to individuals with high risks which involve poor credit records or heavy debts. As a result of the poor credit history, individuals would actually not be qualified for a conventional mortgage loan. Due to subprime mortgage borrowers providing higher risk for lenders, interest rates for subprime mortgages are above the prime lending rate. Thus, the loans typically charge two to three percentage points more than those to people with less-risky credit profiles. This market has been ruthless due to non-payments and delinquencies.

Due to the higher interest rates, borrowers have not been able to make the larger payments required. Concurrently, the value of their underlying assets, their houses, have declined and hence the ability to either refinance the loan or sell their home at a sufficient amount is vanished. The subprime-mortgage loan faults have initiated a credit crisis that, by corruption, covers many other segments of the credit market. Due to the uncertainty of the extent and allocation of the loans, the valuation of many other structured-finance products is now under great pressure. A consequence of the leveraged structure is that actors that are hit lose largely. Some of the largest subprime lenders have filed for bankruptcy as a result of the credit. The subprime mortgage market has been astringent due to non-payments and delinquencies. As a result, a number of accounting-related accusations have been made against mortgage originators in recent subprime lawsuits.

1.1.2 IASB and FASB response to the crisis

In response to the global financial crisis and recommendations made by the G20 leaders, the world's two accounting standard-setting bodies, International Accounting Standards Board (IASB) and Financial Accounting Standards Board (FASB) commit to bring transparency to investors and to clarify International Financial Reporting Standards (IFRSs) to address new market developments.

IASB is an independent standard-setting body based out of London U.K. which is responsible for developing the IFRS and promoting the use and application of these standards. FASB is a private standard-setting organization designated by the Securities and Exchange Commission's (SEC) to develop the Generally Accepted Accounting Principles (GAAP) within the United States. The SEC is an independent U.S. government agency whose primary responsibility is enforcing the federal securities laws and regulating the securities industry, the nation's stock and options exchange, and other electronic securities markets. (www.iasb.org, www.fasb.org, and www.sec.gov). Together, FASB and IASB directly and indirectly sets accounting standards for a very large number of public entities in the world.

As part of IASB's and FASB's long-standing commitment, accounting issues emerging from the global crisis are addressed by both Boards. The Boards established an advisory group called the Financial Crisis Advisory Group (FCAG), which consists of senior leaders with a broad international experience in financial markets to advise the boards about financial reporting issues arising from the global financial crisis and potential changes to the global regulatory environment (www.iasb.org)

Mid-2008, IASB formed an Expert Advisory Panel to identify valuation, disclosure and fair value issues in illiquid markets. After a six panel meetings the IASB issued draft report from Expert Advisory Panel. In late 2008 IASB provided update on applying fair value and in addition, published educational guidance on the applications of fair value measurement in inactive markets. Both IASB and FASB held their first round table on the global financial crisis in London on November 14, 2008 and then later IASB requested input on guidance regarding fair value measurement and impairments of financial instruments proposed by FASB.

The FCAG has been working on many issues relating to fair value accounting. They have been debating whether fair value promotes financial stability or not, even if the risk is the loss of some transparency. There is an agreement that because fair value account is pro-cyclical, it has been contributed to the financial crisis. However, some FCAG member consider accounting for off-balance items as securitizations and other structured entities have been the real cause behind the financial crisis than fair value accounting. The FCAG is asking for feedback and comments from experts on related issues as well as on how IFRS and U.S. GAAP enhanced in the area of fair value due to the current complexity of the reporting of financial instruments under these two standards. (Financial Times, May 19, 2009)

The table below lists IASB's and FASB's response to the financial crisis during 2008-2009.

IASB's and FASB's Response to the Financial Crisis 2008-2009	
Date	**Events**
2009	
April	IASB and FASB Responds to G20 Recommendations and US GAAP Guidance
March	IASB and FASB announce further steps in response to global financial crisis
	IASB and FASB launch public consultation on a future standard on lease accounting
	IASB seeks input on FASB guidance regarding FV measurement and impairments of financial instruments
	Financial Crisis Advisory Group 3rd meeting
February	Financial Crisis Advisory Group 2nd meeting
January	IASB and FASB form the Financial Crisis Advisory Group (FCAG)
	First meeting of the Financial Crisis Advisory Group to take place in London
2008	
December	IASB and FASB announce membership of Financial Crisis Advisory Group
November	Advisory group considering financial reporting issues arising from global economic crisis
	IASB and FASB announce dates for US and Asian round-tables on global financial crisis
	IASB and FASB to hold first round table on global financial crisis in London on 14 November 2008
October	IASB publishes educational guidance on the application of FV measurement when markets become inactive
	IASB and FASB commit to a global approach to enhance market confidence, rapid appointment of members of the advisory group and the organization of three round tables
	IASB and FASB to create an advisory group to review reporting issues related to credit crisis
	IASB proposes improvements to disclosures and provides update on applying FV in inactive markets
	Trustees express their support of IASB's accelerated steps on the credit crisis
	IASB staff confirm clarification by the SEC staff and the FASB staff is consistent with IAS 39 Financial Instruments: Recognition and Measurement
September	IASB organizes round-table discussion of the revised staff proposal of an exposure draft on Consolidation
	Six panel meetings the IASB issues draft report from expert advisory panel and provides an update on response to the credit crisis
August	Expert Advisory Panel on fair value in illiquid markets discusses disclosure requirements
July	Staff presents a first staff draft of an exposure draft of a standard on consolidation to the Board
June	Expert Advisory Panel on fair value in illiquid markets meets for the first time
	Forming of the Expert Advisory Panel to identify valuation and disclosure issues in illiquid markets

The Financial Stability Forum (FSF) created in April 1999, is also working towards international stability in the economy. FSF seeks information through exchange and international co-operation in financial supervision and surveillance. Their recent projects include recommendations and principles to strengthen the financial system. In 2009, the FSF issued reports called The *role of valuation and leverage in procyclicality,* which address how fair value measurement have been more widely used for financial reporting purposes. At the same time, mark-to-market valuation techniques have become more widely used for risk management purposes (FSF, 2009).

On February 2009, the SEC released a report addressing improvements in the fair value standards. The SEC encouraged improvements in accounting for impairments and the development of additional guidance for fair value accounting in inactive markets. The report further recommends decreasing models to report impairments, by providing investors additional information about current decline in value are consistent with credit quality with the restrictions on ability to record increase in value.

At the same time, FASB issued the second of two FASB Staff Positions (FSPs) to address concerns arising from the current financial crisis relating to accounting for financial instruments. The proposed FSP is intended to apply to certain financial assets such as debt securities classified as held-to-maturity and available-for-sale, loans and long-term receivables not measured at fair value with changes in the fair value recognized through earnings. Furthermore, on May 1, 2009, the FASB Staff Positions (FSP) provided guidance on the fair value measurement of liabilities under FASB *Statement No. 157, Fair Value Measurements* (www.webcpa.com).

1.3 Problem Area

Problems related to fair value accounting have been discussed in a paper by Ernst & Young (2005). The fair value model of the IASB is heavily criticized since the author thinks that allowing estimates for many assets and liabilities have so low reliability that the numbers are not relevant either.

> "*Fair value is a wonderfully powerful expression in the English language. It subliminally awakens all those feelings deep within us of wanting fair dealing and true worth to be recognized and appreciated. It conveys the very essence of truth and fairness: What possible objection can there be to financial statements that report assets and liabilities at their "fair value?"*"

The author thinks that the standard setters sometimes are not using the term fair value in an understandable way. One example is that under the fair value hierarchy, managements own mathematical models will be used in cases where no market value is available for the asset or liability in question, as an estimate for "fair value". In the center of all the other problems fair value accounting emerged again as the hot topic for change. Because of the current events the participants in the fair value accounting debate increased and their arguments became even more sophisticated that further complicated the goal of a common understanding of fair value accounting and its conversion. In these arguments there are opponents that think fair value accounting is the cause of the financial crisis. Some argue that Fair Value accounting did not directly cause the crisis, but it helped fuel the crisis even more, so that the end result was a global financial crisis. According to the SEC mandated study, the causes extend into other areas and that fair value accounting did not appear to play a central role (SEC 2008). The SEC study received 186 comment letters as inputs to the study, compared to that FASB' s 93 comment letters when issuing the SFAS No. 157 in 2006. The financial crisis has apparently triggered the debate and we are interested to look further into these problems.

1.4 Purpose

Using a case study of comment letters, our purpose is to examine the debate about fair value in accounting which has arisen in the context of the current financial crisis.

-What major perceptions can be found in the fair value debate?
-What types of arguments can be found in the comment letters?
-Is there any relationship between the main groups and the opinion groups in the different comment letters that were sent to FASB, IASB and SEC?

1.5 Disposition

CHAPTER 1

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CHAPTER 2

FRAME OF REFERENCE- this chapter presents relevant concepts of accounting

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ANALYSIS- this chapter presents the analysis of the comment letters

CHAPTER 6

CONCLUSION – this chapter answers our research question

CHAPTER 7

POSSIBILITIES FOR FUTURE RESEARCH- this chapter introduces suggestion for a possible resolution of the problems

In summary, the financial crisis started in the US subprime mortgage. The crisis in the US triggered an enormous amount of write-downs of toxic assets. These events led into a global financial crisis and increase in criticism to the fair value accounting standards. The response from the two standard setters, IASB and FASB, was the creation advisory panel that was cooperating together towards a possible resolution to the fair value debate. The next chapter presents the frame of references our thesis in order to explain the issues that are being debated.

2. FRAME OF REFERENCE

This chapter presents the relevant accounting concepts to the debate, specifically the basic fair value measurement and fair value accounting issues that arose during the financial crisis.

2.1 Fair value measurement and Historical cost

Fair value accounting can be described as the practice of accounting that records certain assets and liabilities at their current market value (Hitz, 2007). However, this is the ideal situation on liquid and deep markets with ordinary transactions and products. FASB and IASB have the last years developed a methodology on how to determine the "ideal current market value", even when no market exist. In order to understand the fair value accounting debate, one has to understand the basic measurement issue.

There are several broad concepts for measurements including historical cost, current cost, net realizable value, present value of future cash flows, and current market value. Fair value accounting and historical cost refer to several different accounting concepts and measurement bases. Historical cost refers to different measurements bases relating to past entry price (SEC 2008). Historical cost is more explicit the "amount of cash, or its equivalent, paid to acquire an asset or received when an obligation is incurred" (SEC, 2008). Usually, historical values are after recognition modified for impairment, depreciation or amortization. Fair Value is represented by measurements relating to the present; current entry price, current exit price, current equilibrium price, value in use, or even future exit or entry price (SEC 2008).

Despite the different measurement basis, fair value accounting and historical cost relates to different accounting concepts (Nissim, Penman, 2008). Financial statements reveal numbers through the balance sheets and income statement. Income equals the change in equity in the balance sheet (other than transactions with owners). Financial statements consist of two bottom-line numbers, net income in the income statement and book value of equity in the balance sheet. Determination of assets and liabilities also determines income, and vice versa. Accordingly, accounting based on asset and liability recognition and measurement in the balance sheet produces a residual income measure. Vice versa, accounting based on income measurement produces a balance sheet as a residual. Historical cost accounting is associated with income determination. The underlying idea is that value is generated from a business plan that buys inputs and sells outputs for higher prices. Historical cost accounting does not report the present value of the business plan or the value of individual assets employed in the value adding process (Nissim, Penman, 2008). The income statement conveys information about the (realized) value added transactions performed by the company in a specific period, (Riahi-Belkaoui, 2004). The value of the business is determined by projections of future earnings or cash flows based on the realized value added transactions (Nissim, Penman, 2008). Under the asset/liability accounting model, the income statement shows revaluations of assets and liabilities from one period to another, often referred to as economic income (Riahi-Belkaoui, 2004). The balance sheet is made up with current market values while earnings are uninformative about future earnings and about value. Under this model, the balance sheet consists of values of individual assets and liabilities. No income measurement is needed, the income statement will instead inform about value at risk. The conceptual problem is that even if individual assets and liabilities may have identifiable prices, those prices may not represent value since every business manage assets and liabilities according to a business plan, not individually (Nissim, Penman, 2008). As standard setters gradually adopted an asset/liability view with focus on the balance sheet values, the concept of historical prices do not fit in well (Hitz, 2007). FASB have been the leading standard setter in developing the current Fair Value measurement methodology. Next section will explain the concept in detail.

2.1.1 US GAAP Version

The core of the recent debate about fair value accounting goes back to SFAS No.157. The standard provides definitions of the fair value accounting concept and a methodology to reach the ideal market price. SFAS No. 157 paragraph 5 defines Fair Value as:

> "*Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date*"

The objective is to determine the ideal, hypothetical exit price that would be settled at the measurement date (SEC, 2008). Market participants are assumed to be independent, knowledgeable, able to transact and willing (SFAS No.157, paragraph10). The exchange is assumed to be an orderly transaction, it is not a distressed sale or forced transaction. If the entity operates in several markets the reference market is the most advantageous one. A Fair Value measurement assumes the highest and best possible use of an asset. Transaction cost shall be considered when determining the most advantageous market but the price itself should not be adjusted for transaction costs (SFAS No.157, paragraph.9). The asset or liability might be a standalone asset or liability or a group of assets and/or liabilities, or even a reporting unit. Liabilities must be adjusted for credit and liquidity risks if market participants would include that in their pricing models. SFAS No.157 describes three different valuation techniques; the market approach, the income approach and the cost approach (SFAS No.157 paragraph.18). The market approach is based on quoted prices and other information involving identical or comparable assets or liabilities. The income approach uses valuation techniques to convert future cash flows or earnings to a single present amount. The cost approach considers the amount that would be required to replace an asset's service capacity adjusted for obsolescence (a broader concept than depreciation).

FASB have also developed a fair value hierarchy for inputs used in the different valuation techniques. The hierarchy consists of three different levels; level 1, level 2 and level 3 estimates (SFAS 157 No.157, paragraph 22). Observable market information is preferred compared to company specific information. Accordingly, the fair value hierarchy gives the highest priority to market inputs that reflect quoted prices in active markets for identical assets and liabilities. Reaching fair values using market prices are commonly referred to as mark- to -market accounting (Ryan, 2008). Level 2 includes quoted prices of similar instruments in active markets, quoted prices for identical or similar instruments in inactive markets, or observable market information that differs from quoted prices, and finally it includes inputs derived from other market-corroborated data. Level 3 represents measurements that incorporate unobservable inputs that reflect the reporting entity's own assumptions regarding future cash flow and interest rates (SFAS No.157, paragraph 24-31). Estimating fair values using level 3 inputs are commonly referred to as mark-to-model accounting (Ryan, 2008). The basic logic is that valuation techniques used should maximize the use of relevant observable inputs and minimize the use of unobservable inputs (SFAS No.157, paragraph 21). Due to the financial crisis, more and more assets and liabilities have to be valued based on level 2 or level 3 inputs, causing preparers considerable problems (SEC, 2008). Mark-to-model requires judgment and the reliability of the outcome are totally dependent on the subjective assumptions used in the models. The SEC Chief Accountant together with FASB issued an immediate guidance (SEC, 2008). The guidance stated that in some cases using, unobservable inputs might be more appropriate than using observable inputs. FASB issued additional guidance by making amendments to SFAS No.157 (FASB, 2009).

FASB STAFF POSITION No.157-4 contains guidance's on how to determine if a market is active and when a transaction is orderly or not. Among other indicators of a disorderly transaction, FSP No.157-4 p.16 c states that seller is in or near bankruptcy or receivership or the seller was required to sell to meet regulatory or legal requirements.

2.1.2 IFRS version

The FASB and IASB are since 2006 working on a joint program on converge Fair Value accounting (Memorandum of Understanding, 2006). IAS 40, paragraph 5 defines Fair Value as:

> "*The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction*"

The definition differs in three important ways. The definition in SFAS 157 is explicitly an exit price. The definition in IFRSs is neither explicitly an exit price nor an entry price (SEC, 2008). Additionally, the definition in SFAS 157 explicitly refers to market participants. The definition in IFRSs refers to knowledgeable, willing parties in an arm's length transaction. FASB: s Fair value definition is more of market-based measurement and IASB: s is more an entity-specific measurement. For liabilities, the definition in SFAS 157 refers to that the liability is transferred to counterparty; it is not assumed to be settled with the counterparty.

IASB Expert Advisory Panel, like FASB and SEC, opened up for the possibility that observable might not be representative to Fair Values. In such case, management estimation models might be used to adjust observable prices even if more weight should be place to observable market prices. IASB Expert Panel seems to have adopted a stricter view of the fair value hierarchy concept. For example, they state that transactions during bankruptcy should not automatically be assumed to be forced (IASB Expert Advisory Panel, 2008, paragraph 25). On the other hand, as noted above, FASB view the existence o a sale during a bankruptcy as an indicator of a disorderly transaction. Another example is that SEC and FASB (2008) state that transactions in inactive markets may be inputs when measuring fair value, but would likely not be determinative. IASB Expert Advisory Panel (2008) view is that transaction prices in inactive markets are likely to reflect market conditions. In inactive markets, entities should use a valuation technique considering both observable market prices but also unobservable data. It is not appropriate to conclude that all market activity in inactive markets represents forced transactions. An entity should not conclude automatically that any transaction price is determinative of fair value, although they state that observable transaction prices is likely to reflect current market conditions (IASB Expert Advisory Panel, 2008, p.18). Moreover, IASB Expert Advisory Panel (2008) also provided a definition of an active market. “An active market is one in which transactions are taking place regularly on an arm’s length basis”.

In summary, the goal fair value measurement is to arrive at a hypothetical exit price between market participants using different valuation techniques. The fair value hierarchy concept concerns the level of reliability that generally can be placed on different inputs. The most reliable inputs are prices for identical assets in active markets. Internal estimations based on company-specific information are the least preferable inputs. Due to the financial crisis, Fair Values are to a greater extent dependent on level 2 and level 3 inputs. FASB, IASB and SEC have been issuing additional guidance saying that unobservable inputs may be a better estimate of Fair Values in inactive markets, or when transactions appear to be distressed. FASB and SEC seem to be more open for changes in the fair value hierarchy concept than IASB.

3. METHOD

This chapter describes the methods we used and the course of action we took to gather and put together information.

3.1 The Qualitative Method

Maxwell (2005) writes that several authors distinguish qualitative and quantitative methods. Some are fundamental and some actually have no explicit difference and that "*dividing the two is false*" as pointed out by Layder (1993). It is believed that the difference between a quantitative and a qualitative method lies in the way that they are actually used. Thus, when using a qualitative method entails usage of a collection of words, whereas using quantitative method involves a collection of numbers. Furthermore, the quantitative research is an inquiry into an identified problem, based on testing a theory measured with numbers, and analyzed using statistical techniques where researcher is done by using tools, such as questionnaires or equipment to collect numerical data. The general goal of quantitative method is to determine whether the predictive generalization of a theory hold true. On the other hand a study that is based upon a qualitative process has the goal of understanding a social or human problem from multiple perspectives and where the research is the data gathering instrument.

Our approach lies in both the qualitative and the quantitative method. Bryman and Bell (2005) state that the qualitative method is generally used when trying to study some sort of phenomenon in getting a deeper understanding. They further point out that there is a close relationship between what is being researched and the researcher and how the behaviour of the researcher can affect outcome. Our approach through the analysis on the expert debates to provide a good overview on the subject matter and the collection of comment letters relates to both the qualitative as well as the quantitative method. The review of comment letters being the main focus of our thesis is data in form of words as related to a qualitative approach. The actual results in the number of letters for each group, which is in form of numbers, relates to the quantitative approach. Furthermore, qualitative research being subjective, where individuals' interpretation of events is important, we have the comments in writing made by participants in observation of fair value. Quantitative approach is more objective and seeks precise measurement and analysis of target concepts, which again relates to the actual number of letters in form in percentage (Ch. 5.1). Thus, this explains that ultimately we have taken advantage of using both approaches.

3.2 Data Collection

When collecting data, researchers often distinguish between primary or secondary data. Primary data is new data collected for the research while secondary data refers to date already collected. In our study, we primarily used primary data. The secondary sources used are process data such as research articles and books. The main and primary source of our data comprised of 218 comment letters sent to FASB, IASB and SEC regarding the use of fair value during the financial crisis. In collecting the secondary sources, we used the public library online recourse, different financial and accounting newspapers and a variety of different articles from the web. The time frames for the resources were ten years. The articles that dated ten years back were used get a deeper understanding of the whole measurement debate.

3.3 Our research approach

This section is explaining how we approached the research on our thesis. The research evolved around different comment letters in order to help us gain a better understanding of the different viewpoints in the fair value accounting debate. The approach on itself started first with looking into the background of the different comment letters and then it emerged into finding different ways of executing out study. While examining how to execute the study we created a flow chart in order to be able to better analyze the letters. The subsections below explain our research method further.

3.3.*1 Background to the Comment Letters*

The SEC's performed a study on mark-to-market accounting in late 2008 (SEC, 2008). The mandate for their study came from the Emergency Economic Stabilization Act which was signed into law on October 3, 2008. Section 133 of the Act mandates the SEC, in consultation with the Federal Reserve and the Secretary of the Treasury, shall a study on mark-to-market accounting standards (SEC, 2008). The Emergency Economic Stabilization Act mandated SEC to look into the following areas:

1. The effects of such accounting standards on a financial institution's balance sheet;
2. The impacts of such accounting on bank failures in 2008;
3. The impact of such standards on the quality of financial information available to investors;
4. The process used by the Financial Accounting Standards Board in developing accounting standards;
5. The advisability and feasibility of modifications to such standards; and
6. Alternative accounting standards to those provided in such Statement Number 157.7

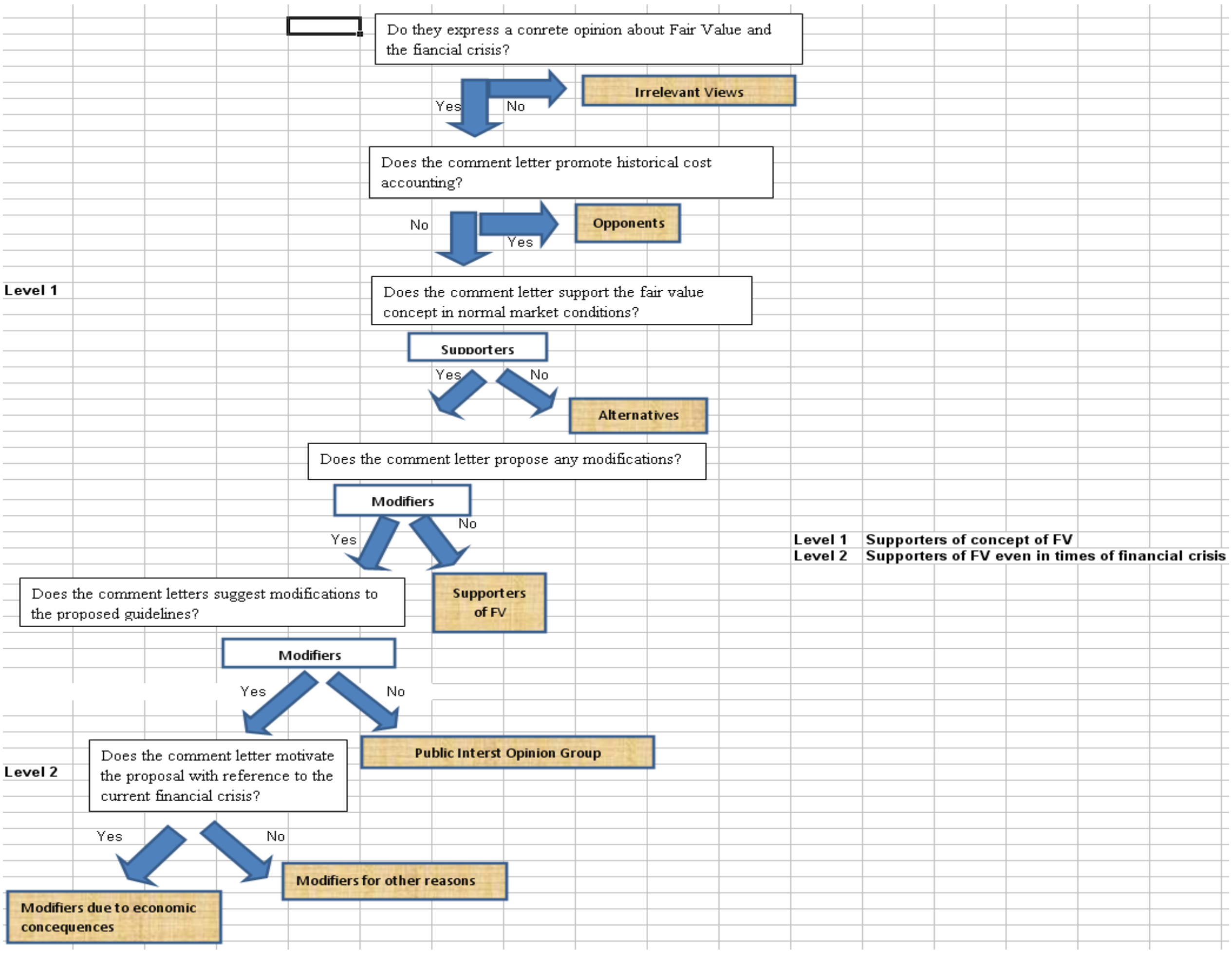
The SEC requested the respondents to comment on these matters. The SEC received 186 comment letters. The other 32 comment letters we have analyzed were sent to IASB and FASB as inputs to their three joint public roundtables in November and December 2008. Unlike the SEC study, these roundtables were more general in that sense that the purpose was to identify financial reporting issues that need more attention in the light of the global financial crisis. The SEC and FASB had in September 2008 issued their guidance of Fair Value accounting in inactive markets and IASB Expert Advisory Panel issued their guidance on the same matter in October 2008. Most of the comment letters therefore focused on the use of different valuation techniques. By consequence, definitions of active/inactive markets, orderly/disorderly transactions, related to the fair value hierarchy measurement concept are discussed in the comment letters. We have chosen the comment letters sent to SEC, FASB, and IASB because they represent the most controversial debate in accounting. Fair value accounting has been blamed for the financial crisis and the SEC can suspend the use of fair value accounting. Although the comment letters sent to SEC address more specific questions than the other comment letters, we believe all comment letters in general focus on the same issues. All the comment letters are comparable because they all express opinions about Fair Value accounting that enable us to see the issues from different angles.

3.3.2 Execution of the Study

The comment letter were initially split up between two people and read through once. One person took the 14 letters that were sent to IASB and the other person took the 18 letters sent to FASB. After each person had read the letters, we switched and read the remaining once. We then debated about potential groups for classification. We started to divide the list of commenter's on fair value accounting matters into six different groups. The list of commenter's consists of preparers, users, auditors, standard setters, academics and other public opinions. The initial thought process for the group's formation was to place certain general expectations for the comment letters. The preparers group includes preparers, preparer-related professional organizations and advisors to preparers. The user's group included consultants, professional organization, investors and other related users. The auditor's group consisted of the big four audit firms. The standard-setters group included different standard setting organizations. The academics group consisted of different academics from the US. The other public group included other private individuals that commented on issues without representing any specific area of business. The first initial groups we named main groups. So, after finding the main groups we went back to the text, read the first set of comment letters and identified them according to which potential sub-categories we could classify them in. The further classifications were based on a set of questions that we developed while reading the comment letters. These groups received the name opinion groups. The opinions groups consisted out of groups that we called opponents, alternatives, and supporters of fair value, public interest opinion group, modifiers due to economic consequences and modifiers for other reasons. Once we had identified the opinion groups we wrote down a set of initial characteristics for each of the groups. We explain it more in detail in section 4.2. After this step we created a flow chart to give the readers a visual of our flow of opinion groups. The flow chart can be found in Figure 3.3.3 and more in detail in the next section.

3.3.3 Our Flowchart (Figure 3.3.3)

After having read all the comment letters, identified the criteria for the opinion groups and given our different opinion groups names, we created a flow chart. This chart's serves as a visual tool for better understanding of our approach to the study. First, we started asking ourselves if the comment letters expressed any concrete opinions about fair value and the financial crisis. If they did not have any particular opinions or if they talked about a different topic, we separated them into a group that we called Irrelevant Views. If the letters had relevant opinions about Fair Value, we went a step further and asked the question if the comment letter's promoted historical cost accounting. If they did express positive statements about historical cost accounting and if they provided a rather negative picture of fair value we categorized these letters as Opponents of fair value. On the other hand if the letters were rather positive and expressed support and reasoning for fair value, these letters were set aside for further questioning. At that point, these letters represented a level one of our study where we could see a common support for the overall fair value concept.



After identifying the common supporters of fair value, we continued to further ask if any of the remaining letters supported fair value accounting in normal times. If the answer was no we placed them into an opinion group that we called alternative. This opinion group had comment letters where they had rather very critical opinions for fair value even but they didn't promote historical cost accounting. The remaining letters were asked further questions. We examined the letters while asking the question if these letters, even though they were supporting the Fair Value concept, were proposing modification to fair value. If they did not call for any modification we labeled them as Supporters of fair value, but if they did want more modifications we asked additional questions. In particular, we asked if these letters were specifically calling for modifications for the proposed Fair Value guidance's, recently issued by the SEC/FASB and IASB (IASB Expert Advisory Panel, 2008, SEC Guidance 2008). If they did not want modifications to these guidance's, they were fitted into the group of the Public Interest Opinion Group. The opinion group got the name Public Interest Opinion Group because they support the concept of fair value while criticizing it and still urge for fair value change other than the proposed guidelines. The last question we asked was whether the comment letters proposal was motivated by the current financial crisis. If the letters that expressed their views in terms of the current financial crisis, fair value and the economic consequences it had, we categorized these letters into the group Modifiers due to economic consequences. This was not the case they were moved into the group of Modifiers for other reasons. Once we have all the letters separated into different opinion groups we were ready to continue to look into any possible relation between our main groups and the set opinion groups.

3.4 Reliability and Validity

The two most common measuring terms used in theses are *reliability* and *validity*. Reliability can be defined as the result of a process that produces consistent and predictable results that can be replicated (Martin 2005). In order to enhance the reliability of a process or a project, the number of variables should be reduced and a rather quantitative, bias-free measurement should be used (Ibid). But when one enhances the reliability while reducing the variables, one reduces the validity as well (Ibid). These two terms seam to conflict with each other, so it is important to find a good balance because a study without these two aspects is not possible.

To ensure reliability in qualitative research, examination of trustworthiness is crucial. Seale (1999), while establishing good quality studies through reliability and validity in qualitative research, states that the "trustworthiness of a research report lies at the heart of issues conventionally discussed as validity and reliability" (p. 266). When judging (testing) qualitative work, Strauss and Corbin (1990) suggest that the "usual canons of 'good science'…require redefinition in order to fit the realities of qualitative research" (p. 250).

In our thesis we used a lot of newspapers and government reports in order to assure that the source itself can be trusted. During our material gathering phase we came across a problem that not all the information that was written online could be said to be reliable and relevant. In order to pick the best possible information available we place great caution where the information came from. When picking the newspaper articles we paid very close attention that the articles were from major newspaper agencies that had the reputation to be reliable source of information. On the other hand the government report was chosen because it was an SEC report that was mandated by the US Congress in order to look into the possible suspension of fair value accounting. When picking the SEC report our reasoning went to the fact that SEC is a very well known and very powerful organization around the world, so its reports could be trusted to be reliable and valid.

In our expert debate we have read and interpreted 218 comment letters. This particular procedure can be argued to be very subjective and therefore it only gives a certain degree of reliability to our debate. In this debate the reliability is dependent on the fact how the information is being interpreted. In our process two people have read all the comment letters twice independently and individually. After the reading all the comment letters we screened and separated the once that were hard to classify. Once everything was separated, we discussed all the possible group placements based on the initially set criteria. During the already mentioned process we created a flowchart diagram that was a guiding tool for the formation of the opinion groups. The flowchart added to our reliability because it was created to be asking clear cut questions where one was asked to answer these questions with yes or no. The flowchart played a central role to increasing our reliability. All these things were done in order to be certain that nothing was misunderstood or misclassified. With these procedures we wanted to uphold the relevance and reliability of our study. Even with all the procedures and our best efforts to be very thorough there is always a risk that our own values and understandings affected how the comment letters were interpreted. The interpretation of the comment letter and the grouping was very critical in our study. It was very important that the grouping and interpretation of the main and opinion groups were done by several people at different times in order to be able to replicate the same results and so with that make the interpretation more reliable. One of the limitations of the grouping are that the main groups could be classified differently. For example, the main groups could be classified based on their respective industries or eventually countries. Our decision not to do so was based on time limitations and the fact that it could have made the topic more complex and more difficult to follow. We put a lot of effort, thoroughness and care to make sure all our research could be traced to reliable sources and process.

In summary, we examined and analyzed different comment letters from SEC, FASB and IASB. This process was done with the aid of a flow chart that was design by us. The purpose of that was to find an effective way of analyzing the various comment letters. This section gives the reader insights into how we approached the examination and analysis phase of our research. The next chapter categorizes and explains the main and opinion groups.

4. EXPERT DEBATE

In this chapter we will explain the empirical findings. It examines and explains the seven main and opinion groups.

4.1 Our Main Groups

In the accounting literature groups are normally divided into users, preparers, auditors, and academics. In our public debate we used these common groups to classify the 218 comment letters we have studied. In addition to these common groups we added standard setters and other public group to our classifications. The 218 comment letters were distributed according to the role in the economy the commentator represented, independently from their opinions in the comment letters. The main groups were added because we wanted to examine any potential differences in opinions between the groups.

The preparer group consisted of those who prepare their own accounting information, preparer related professionals and organizations and advisors to preparers. This group mainly includes different companies across different industries. The banks and the financial institutions were also included in this section because they represent the predominant preparer of fair value accounting.

The users group is mainly consisting of different individuals and companies that use and analyze the accounting information rather than prepare it. These groups primarily use the accounting information as a means to sound investment decisions, conducting company valuations and other similar tasks. For example the user's group includes consultants, professional organizations, investors and other related users.

The auditors group is the group that attests the annual reports. They also make sure that the financial statements and other accounting information are correct and follow the respective accounting principles. The standard setters on the other hand are the authoritative body that sets the rules and principles that the profession is obligated to follow. These groups were assigned groups of its own because of the roles the authoritative bodies play in the accounting industry.

The academics groups consist mainly of professors from different Universities. Because they do not fit into any of the other groups, but their input is important, they were assigned their own group. Also, their role in the accounting profession is a very critical one, since their contribution and their comments serve as an eye opener to other professionals.

The other public group includes other private individuals that commented on issues without representing any specific area of business. This particular group was created to assign the individuals that do not fit into the other groups. In the Appendix I there is a full list of comment letters and their distributions between the six main groups.

4.2 Opinion groups

This section describes the different criteria's that were used for the opinion groups and gives detailed examples from the comment letters in order to give a better understanding of the group formations.

4.2.1 Irrelevant Views

As the name already suggests this group was created because some comment letters do not provide any relevant or even educated views on the topic provided. This group mainly consists of irrelevant opinions that were not possible to classify. A good example is the opinion that ordinary taxpayer's money has been used to bailout corrupt companies own mistakes. The views in this group were weeded out right from the beginning in order to be able to come to a relevant debate about the subject matter. For example the user's group comment letters that were categorized into irrelevant views are portrayed below:

> *"Please do away with mark to market valuation and restore mark to reality valuations (Mcallister 2008)."*

> *"YOU SAY YOU'RE PROTECTING THE INVESTOR. I GUESS SUING THEM DOESN'T COST MONEY. I, LIKE OTHERS, HAVE ALREADY LOST MY LIFE SAVINGS AND I*

ONLY HAVE A FEW YEARS LEFT TO WORK, IF I LIVE THAT LONG. THE ILLUSTRIOUS GOVERNMENT BAILED OUT COMPANIES AT TAXPAYER EXPENSE. YOU AND ALL THE OTHER POLITICALLY CORRUPT GOVERNMENTAL PEOPLE CONTINUE TO SPEND MY TAXPAYER MONEY AND YOU DIDN'T EVEN FORCE THE GOLDEN PARACHUTISTS TO GO BANKRUPT AND TAKE EVERYTHING THEY HAD/HAVE TO REPAY THE INVESTORS. INSTEAD, YOU GAVE THEM MONEY--MY MONEY WHAT ARE YOU GOING TO DO FOR ALL THE PEOPLE WHO HAVE NO SAVINGS, PUT THEM IN A CONCENTRATION CAMP AND GASS THEM ALL? YEAH THE BABY BOOMERS WERE SUPPOSED TO BE ABLE TO RETIRE ON WHAT A PIECE OF PAPER THAT'S WORTHLESS? YOU AND OTHERS LIKE YOU SUCKED THE LIFEBLOOD OUT OF SOCIAL SECURITY. THANK YOU. AND NOW WE HAVE A MULTI TRILLION DOLLAR DEFICIT THAT NOBODY'S GOING TO BE ABLE TO PAY OFF. EVERYBODY IN GOVERNMENT IS ABLE TO CARRY A DEFICIT AT THE EXPENSE OF THE TAXPAYER BUT THE TAXPAYER IS EXPECTED TO MAINTAIN A BUDGET. WHY CAN'T YOU AND OTHERS LIKE YOU LIVE ON A BUDGET? WHO SPENT BEYOND THEIR MEANS (Bjork 2008)."

4.2.2 Opponents of Fair Value

This group consists of comment letters that take a negative stand to fair value accounting. This group's negative perspective range not just to a specific area of fair value, but they extend into the whole concept of fair value. They also go so far as to blame Fair Value accounting for the financial crisis. The quote below from William M. Isaac, Chairman of the Secura Group of LECG and former Chairman of FDIC, illustrates a typical opinion of an opponent and a user of fair value.

"I believe it is beyond dispute that mark-to-market accounting has been extremely and needlessly destructive of bank capital in the past year and is a major cause of the current credit crisis and economic downturn (ISAAC 2008, p.6)."

In addition to just putting blame on the fair value accounting concept, the comment letter propose an immediate abandonment of the concept and a return to historical cost accounting. These comment letters truly believe that the historical cost accounting is a better accounting model. For example William M. Isaac also says:

> *"I believe the FASB and the SEC should immediately withdraw SFAS 157. Moreover, it is my fervent hope that the SEC will recommend in its report to Congress that we abandon mark-to-market accounting altogether (ISAAC 2008, p.6)."*

> *"Can we have a system that reflects market pricing while not eradicating earnings and masses of capital when the markets swing in one direction or another or are in disarray? I believe the historical-cost accounting model, which is the cornerstone of Generally Accepted Accounting Principles, accomplished these objectives exceptionally well for decades before we decided to experiment with mark-to-market accounting. Under historical-cost accounting, marketable assets are carried on the books of banks at their amortized cost, and the balance sheet contains footnoted tables showing the current market value of those portfolios (ISAAC 2008, p.7-8)."*

In these comment letters the opponent's also argue that since fair value can only be implemented to a portion of the asset side of the balance sheet, fair value produces mismatched results. In addition, the group makes a point that the current practices of fair value accounting creates an enormous procyclicality effect which ultimately leads to distorted and obscured values. William M. Isaac also argues:

> *"This historical-cost system does not run the market depreciation through the profit and loss statement and does not deplete capital (unless the diminution in value is considered permanent). Moreover, this system does not value one portion of the balance sheet without regard to the rest of the balance sheet. In short, it presents a far more accurate and holistic financial picture of a bank than today's destructive and misleading system of accounting (ISAAC 2008, p.8)."*

In particular, this group's comment letters show concerns for the quality of the underlying accounting documents. Their view is that fair value accounting produces financial statements with low levels of reliability and understandability. Also, some comment letters go as far as stating that they believe that fair value accounting violates every logical decision of a going concern business. And this group's opinions reflect a clear preference for historical cost accounting.

4.2.3 Alternatives

The alternatives group takes a rather critical opinion on fair value accounting without expressing the opinion to switch back to historical cost accounting. Their opinion about the fair value accounting concept is rather positive in good times while at the same time it clearly highlights the inherent flaws in fair value accounting in bad times. The comments below come from the users and preparers group and the comment letters are from Jason Edgtton and Wardell.

> *"The effects of mark-to-market accounting on financial reporting by financial institutions in times of fear may well enhance short term negativity in the market and lead to extream results as clearly seen recently. However in a stable market, the mark-to-market accounting principle provides critical information to the investment community as to the current asset quality (Edgtton 2008, p.1)."*

> *"In times of extream volatility it would seem to be a good idea to question the usefulness of mark-to-market accounting, however just because the truth hurts is no excuse to hide it. However, one aspect to improve could involve placing a maximum percentage decline that could be taken against the relevant assets in any one quarter. This would have the effect of spreading the bad news over a longer period, reducing the panic and lowering the volatility in any given quarter (Edgtton 2008, p.1)."*

> *"The unprecedented market conditions that currently exist highlight the inherent flaws in fair value accounting. Utilizing net realizable value is a more appropriate*

measurement for debt securities that are classified as or available-for-sale, and as the basis for recognizing other-than-temporary impairments (Wardell 2008, p.1)."

The comment letters of this group go as far as suggesting areas to be looked at, but they shy away from drastic actions. This group rather suggests a detailed investigation of the existing flaws instead of jumping to conclusions right away. For example some letters that come from the preparer group state things like the quote below:

"In light of that, we strongly encourage the SEC to conduct a thorough study of the effects of suspending mark-to-market. Like others, we are uncertain what the effect would be on the financial marketplace if mark-to-market accounting is suspended across the board. However, we do feel it is critical that the SEC consider, in a comprehensive manner, the result that changes in the language and application of fair value principles would have in light of the current vagaries that result from the present market (Dunn 2008, p.1)."

The letters that made it into this group provided the reader with a more critical view of the current accounting treatments while maintaining the overall consensus for the current fair value accounting treatments. This group distinguishes itself from the opponents of fair value in the fact that even though they criticize and express doubts about fair value, their opinions are mainly influenced by the current events. Also, this group does not favor the historical cost accounting nor does it support fair value accounting in bad times.

4.2.4 Supporters of Fair Value

As the name implies, this group is clearly positive to the concept of fair value accounting. The comment letter's that are used speak favorably of fair value and support their opinions by reflecting on the possible effects that would be caused by the removal of fair value accounting. For example G. Peter Wilson, an academic from Boston College, says:

"These wide confidence intervals, which result from uncertainty in the marketplace associated with a dearth of predictive information, reflect and partly contribute to

our current crisis of confidence. This does not mean fair-value accounting should be suspended. Doing so will surely increase outsiders' uncertainty about the related assets' future cash flows, which will further depress their estimates of the assets' fair values and delay a recovery (Wilson 2008, p.5)"

Also, this group's comment letters argue that if it were not for fair value, management's questionable performance would lead into more problems. In addition, their views were that management's integrity would be compromised without fair vale accounting. These views are found in the preparer group by Jay Michalowski from Sleeping Bear Partners in the below quote:

"However enticing and difficult this procedure has been, retracting FASB 157 would only service to delay the evitable, encourage corporate lying and make us repeat the mistakes made by Japan with their unwillingness to address their non-performing loan problems (Michalowski 2008, p.1)."

"FASB 157 has no doubt caused pain in the banking system. But let's remember, the pain originated from the poor decisions of bankers, and exacerbated further from the imprecision and lack of FASB 157 enforcement. Current strains are occurring from the resulting "good bank / bad bank" weeding out process. In such, now is the time to be even more resolute (Michalowski 2008, p.1)."

Certain other argument's reflected the opinions that fair value accounting brings the benefits of comparability, relevance and transparency. This group portrays the opinion that despite the possible glitches fair value accounting still gives more value to users of financial information. For example in the comment letter that is found in the user's group that is from the Center for Audit Quality, the CFA Institute, the Consumer Federation of America, the Council of Institutional Investors and the Investment Management Association says:

"In the specific case of fair value reporting, investors require an accounting standard that reports a relevant and useful value of financial instruments regardless of the direction of markets. Fair value accounting with robust disclosures provides more reliable, timely, and comparable information than

amounts that would be reported under other alternative accounting approaches (Fornelli et al 2008, p.2)."

This group of comment letters was grouped on the positive opinions for the fair value concept in addition to providing the different interest groups with relevant, reliable and transparent financial information.

4.2.5 Public Interest Opinion Group

The public interest opinion group's views are rather more positive to the concept of Fair Value, but they distinguish themselves from the supporters of fair value through their extensive opinion's and suggestions. While this group supports the concepts of fair value they still have rather extensive modifications that they would like to see fairly quickly. A good example of this group is the following quote from our preparer group:

"We believe the current application and interpretation of Statements 157 and 115 to Banking Institutions whose primary business model is to operate as a going concern with a longer term time horizon has resulted in unintended consequences. The strict restrictions on transferability and the requirement to measure impaired securities for which the institution has no immediate plans for sale on a liquidation or "exit" price notion is more relevant to active traders versus financial institutions such as Banks. Therefore, we feel that certain targeted amendments to the US GAAP impairment guidelines for available-for-sale (AFS) and held-to-maturity (HTM) debt instruments should be considered (Traficanti 2008, p.1)."

This groups proposals for modifications call for fair value accounting to be required for all financial instruments because they hold the opinion that the reporting would be substantially improved. They also propose that further modifications of statement 157 should focus even more on requiring additional disclosures. In addition to increased disclosures they would like to be able to reclassify their assets according to the management's intent. The comment letters in this group are comprised out of strong supporters for the concept of fair value accounting while proposing robust changes other than to the recent guidelines (IASB Expert Advisory Panel, 2008, SEC, 2008). Also, these letters attempt to explain in a rather extensive manner their recommendations and their reasons for it.

4.2.6 Modifiers due to economic consequences

The Modifiers due to economic consequences group is a supporter of the fair value concept, but it strongly urges for modifications. The comment letters in this group generally believe that the fair value accounting accomplishes the goals of relevant, reliable and transparent financial information when they are under normal market conditions. Also, they all share the opinion that once the market becomes dislocated and illiquid, fair value accounting becomes problematic. They believe that illiquid market condition can result in misleading information and results that do not reflect the underlying transactions. The letters also reflect the views in illiquid markets and the securities fair values do not show the true economic value or for that matter a "true" fair value of the perspective investments. The comments that were grouped in this group can be shown in the following example by Richard A. Dorfman from a preparer from FHL Bank of Atlanta:

> *"A significant amount of financial institutions' lending capacity is being diminished not by economic losses, but by technical accounting rules (Dorfman 2008, p.2)."*

> *"Subsequently, financial institutions are often forced to sell investment assets at distressed prices to raise funding. This ultimately further distorts fair values reported by other entities (Dorfman 2008, p.2)."*

The comment letters go even further so far as to give recommendations to what modifications they want to see in the near future. Also, Dorfman for example says:

> *"For held-to-maturity securities, modify the accounting rules for other-than-temporary impairment recognition to be more closely aligned with the discounted cash flow guidance found in Statement of Financial Accounting Standard No. 114, Accounting by Creditors for Impairment of a Loan. Doing so would better*

correlate the accounting treatment with the true economic loses and the nature of held-to-maturity securities (Dorfman 2008, p.2).”

“Allow for the recovery in fair value of previously impaired securities to be recognized as realized gains. This would align the other-than-temporary accounting model closer to fair value concepts and eliminate the downward bias in the current accounting model (Dorfman 2008, p.2).”

“Direct the Public Company Accounting Oversight Board to issue more specific audit guidance related to other-than-temporary impairment and fair value. In some instances auditors have advised companies to be more than conservative in their fair value methodology. More specific audit guidance would help provide a more consistent audit approach (Dorfman 2008, p.2).”

This group is a very active in the debate and in certain comment letter’s goes even deeper when giving recommendations to modifications of fair value accounting. But the comment letters that suggest modification’s and give recommendations were separated according to which opinions lead to or imply modifications that arose due to economic consequences.

4.2.7 Modifiers for other reasons

The group Modifiers for other reasons is also a supporter of fair value and it also urges modifications, but its motives arose out of reasons other than economic consequences. This group always clearly states the opinion about whether fair value accounting is to be blamed for the financial crisis and then it goes into giving their opinion about potential consequences if fair value was not there. For example the opinions are stated like this can be found in the comment letter from users Nigel Hyde and Marcus Schüler from Markit:

“To be clear, mark-to-market accounting has not caused any losses, it has only been the "messenger", as institutions were forced to acknowledge and reveal write-downs in a timely and transparent fashion. Any alternative or move away from the concept of fair value risks encouraging institutions to not reveal the true extent of

their potential problems. It would thus make the necessary adjustment process more prolonged and more painful for everyone. We are strongly in favor of adhering to the true concept of mark-to-market to determine the current valuation of a financial product for accounting purposes (Hyde & Schüler 2008, p. 2)."

In addition to urging modifications to fair value and supporting the concept of fair value this group also goes further and wants the current crisis examined even further. A good example of that is from Vincent Colman an auditor from PriceWaterouseCoopers LLP:

"We also encourage the Commission and others to undertake a constructive review of the root causes of the credit crisis. Understanding the root causes will help in determining any necessary reforms, including those that go beyond accounting and financial reporting (Colman 2008, p.1)."

As the previous group, this group also consists out of comment letters that gives recommendations of in which direction the fair value accounting needs to be modified. The difference between the previous group and this group is that this group proposal does not reference the financial crisis when talking about the modifications. Also Colman states:

"Lastly, we support exploring possible refinements in fair value reporting, and the related disclosures of fair value measurements. Specifically, in the near term, we believe there are several areas that could be evaluated in regard to reporting periodic changes in fair value, without compromising the core principles of fair value measurement. These include:

1. Consider separating for accounting purposes the periodic changes in fair value into two components: (1) incurred credit losses and (2) all other changes in fair value (including, for example, liquidity discounts).

2. Consider converging the guidance for reporting financial asset impairments by recognizing (1) incurred credit losses in income and (2) all other changes in fair value in other comprehensive income until the asset is sold or matures.

3. Consider changes in the format of the income statement to allow for (1) more visibility to the income effects of items reported at fair value and (2) the inclusion of other comprehensive income on the face of the statement (Colman 2008, p.1).”

The comment letters that came from this group represent the supporters of the concept of fair value accounting that do not assign blame to accounting for the financial crisis, but still ask for modifications. The requested modification and recommendations are rather superficial changes than changes that were motivated for purely economic reasons.

In summary, this chapter goes deeper into the description and criteria for each of our main and opinion groups. While describing each of the criteria, the paper gives examples for the reader in order to better understand the groupings. The next chapter analyzes our study of the comment letters.

5. ANALYSIS

This Chapter is concerned with relations between the main groups and the seven opinion groups. Also, it attempts to analyze the arguments used in the debate.

5.1 Relation between Main Groups and Opinion Groups

In the previous Chapter the main groups and the opinion groups were described in detail in two separate sections because these two groups were classified independently from each other. The question in our study is whether the opinion groups' arguments can reveal any differences in which kind of arguments different opinion groups use. This section will explain the patterns we found about how the opinion groups are arguing. Once such concerns are found, this section becomes specifically interesting in revealing whether there is a pattern in concerns within, as well as across the opining groups. The table below serves as a base for the analysis. In the table the left vertical columns represent the different opinion groups and the right horizontal rows represent the different main groups.

Main Group divided into opinion groups	Preparers		Auditors		Standard-setters		Academics		Users		Total	
	Nr.	Pct	Nr.	Pct	Nr.	Pct	Nr.	Pct	Nr.	Pct	Nr.	Pct
Opponents	2	3%	1	11%	0	0%	2	22%	9	7%	14	6,4%
Alternatives	31	46%	3	33%	0	0%	3	33%	67	52%	104	47,7%
Supporters	6	9%	4	44%	3	60%	2	22%	21	16%	36	16,5%
Public Interst Opinion Group	12	18%	0	0%	0	0%	0	0%	1	1%	13	6,0%
Modifiers for other reasons	12	18%	1	11%	2	40%	0	0%	8	6%	23	10,6%
Modifiers due to economic consequences	4	6%	0	0%	0	0%	1	11%	4	3%	9	4,1%
Irrelevant View	0	0%	0	0%	0	0%	1	11%	18	14%	19	8,7%
Total	67	100%	9	100%	5	100%	9	100%	128	100%	218	100,0%
Nr. = Number Pct = Percentage												

5.2 View's of Alternatives opinion group

The alternative group is by far the biggest opinion group (47.7%) and users represent more than half of the group. The alternative group arguing to a big extent the same way as opponents but they don't promote a historical cost model. They argue that fair value accounting should either be blamed for the financial crisis, or with its perceived procyclicality effects contributed to it.

Consequently, the predominant view among this group is that SFAS 157 should be suspended. However, some of the comment letters develop the arguments on the reasons why they view Fair Value accounting as economically harmful. Some of the commentators point out that fair value accounting is based on the wrong premise; that the market value is the most accurate reflection of an asset. They argue that the market efficient theory doesn't always hold on in reality and that prices can be manipulated, especially in illiquid markets. Several commentators argue that a discounted cash flow model should be a better measurement basis than market value. They believe a value based on estimation of future cash flow is more relevant than the market value of an instrument. The reason is that if the current market value produces a lower return, companies will likely hold the instrument. In a depressed, inactive market the management's estimate of future cash flow is likely to be more relevant in the estimation of current fair value. Furthermore, some of the comment letters argue that Fair Value accounting seriously contradicts the going concern premise, and one comment letter even suggest that Fair Value accounting is a perfect model in societies where there is no tomorrow. There are commentators that think Fair Value accounting exaggerated the "real economic losses", arguing that only 2% of the real estate properties in US are in a foreclosure but market values are down to nothing caused by enormous write-downs.

5.3 View's of Supporter's of Fair Value opinion group

The supporters of Fair Value are about 16.5% of the whole 218 comment letters that were analyzed. This group is the second largest group after the alternatives opinion group. This group's views support fair value accounting and strongly oppose any suspensions of fair value accounting. Their opinions are not different across the different main groups because all the main groups believe that fair value is beneficial during normal market conditions. They share the view that fair value accounting is the best option even when in times of a financial crisis these accounting treatments show weaknesses. The view is that fair value accounting is the best alternative because it has a higher transparency and they reflect more accurately the economic reality of the underlying assets and liabilities. Also, this group believes that a suspension of the standards will only lead to a decrease in transparency that will increase investors' concerns about the reliability of the financial information and ultimately eroding the market conditions even further.

5.4 View’s of Modifier’s for other reasons opinion group

The Modifier’s for other reasons represents about 10.6% of the pooled comment letters. This group supports the fair value concept and does not believe that fair value caused or contributed to the current financial crisis. Also, this group does ask for modifications, but the modifications are not driven by the economic consequences that arose during the crisis. All of the four main groups agree and relate to the argument for modification in other areas. In addition to that all three groups respond by making suggestions on what they want to see changed. All the main groups agree one particular change. They all address a change where it would be allowed to reclassify assets out of the fair value through profit and loss category if there is a clear change in business intent to hold the instruments as a result of the lack of market liquidity. In addition to these changes the different main groups ask for other changes as well. For example the standard setters group is a supporter of fair value accounting, but it strongly proposes changes to the accounting treatment. They believe that a couple of issues need to be addressed as soon as possible if improvement is there to be made. For example one of the comment letters came from Jorgen Holmquist from the European Commission of Internal Market and Services DG. In his comment letter he says that on October 21 the European Commission had organized a meeting with European Stakeholders, which included representatives of preparers, investors, auditors and regulators, where they emphasized the need for change to the problems that arose during the financial crisis. One of the issues that they addressed was the need for clarification on whether the synthetic CDOs include embedded derivatives (Holmquist 2008). In addition to the already mentioned they talk about adjustments to impairment rules that are applicable to the available-for-sale financial assets (Holmquist 2008). As for the users they suggest that the fair value hierarchy be amended to require that the company take into account both market price and the discounted present value of the estimated cash flows (Dicke 2008). The preparers on the other hand, they want further enhancements and improvements to the transparency through the use of disclosures. The preparer groups also ask for modification in the approach to the reporting periodic changes in fair value and aligning the accounting guidance for loan impairments with the accounting guidance for impairments of debt securities. This group ultimately asks for other modifications that are not related to the economic consequences. In addition, the different opinion group's request changes that are influenced by their views of what is best for their area of business.

5.5 View's of the Irrelevant View opinion group

As the name already suggests it the opinions that were included in these groups do not fit into the scope of our research, so they were separated into its own category. This category took up 8.7% of all the 218 comment letters that were analyzed. The letters in this group were not further analyzed because the different opinions went off topic and were not relevant to fair value accounting. But it comes to point out that one should exercise judgment when considering different views in their decision making process.

5.6 View's of Public Interest opinion group

Preparers of financial statements are the predominant main group among this group. Almost every member of the public interest opinion group share the view that reclassifications between ASF, and HTM and Loans should be allowed. Their argument is that business intent and accounting have to be aligned. Further on, they oppose current rules for the impairment for HTM assets. Specifically, they do not believe it meets the required accounting characteristic of representational faithfulness. One common argument among this group is that if management has the intent and ability to hold investment securities until maturity, recognition of a loss based on the fair value in a distressed market will result in significant disparity between the accounting loss reported in the financial statements and the ultimate economic loss. They believe that only credit impairments should be recognized and not impairments due to lower market values. Some of the commentators also recommend the SEC to review auditor practices concerning these areas. The commentators are concerned that auditors are too conservative and have forced companies to exaggerate impairments.

5.7 View's of Opponents opinion group

Among opponents, there is no single argument that can be said to be common for this group. We have found a strong relationship between users and this opinion group (9 out of 14). However, almost every comment letter in this group is arguing that the practice of fair value accounting is in some way economically harmful to either banks or the entire financial system or both. The arguments used to reach the conclusion that fair value is economic harmful differs. One view is that fair value can be described as manipulation and intrigue modeling that threatens the credit system and the financial stability. Another view is that fair value concept is economically harmful because it fails the accounting qualities of faithful representation and comparability. The comment letter exemplifies two comparable companies in the same business, one that has poor management and one with excellent management. The credit rating on the first company will go down and the market value of their debt will decrease resulting in an increase in their shareholders' equity. In our study, across all the main groups, the majority of the comment letters share the view that fair value accounting is dangerous to banks and that it creates and inherent procyclicality in the economy. According to this argument, fair value produces misleading results well below the true economic value when markets are not function properly. Distressed market prices doesn't reflect the true economic values of securities, it's just reflecting that there are a few very risk adverse willing buyers and lots of distressed sellers. Accordingly, even non-distressed banks have to charge for impairment losses even though they are not intending to sell. The Pro-cyclical effect has been extremely destructive of bank capital and is a major cause of the economic crisis. Another comment letter uses the situation on the mortgage market as an argument. There are a lot of distressed sales of mortgage loans that are forced liquidations. These distressed sale prices are not indicative of the fair value of that property. In an illiquid market, it forces financial institutions to value these assets at prices that are less compared to its discounted cash flow. Another view is that fair value is economically harmful because it has incentives for short term actions. The argument is that fair value subordinates underlying tangible transactions by reassessing them through the marketplace. Large market shifts can overshadow the operating activities of a company. Since the management of a company makes decisions based on the relative impact it will have on the financial statements, they focus on the affect of their decisions on the market as opposed to the affect on operations.

The opponents have also arguments of why historical cost is a better accounting model. Some of the comment letters have the view that the historical cost model meets the information needs of several interest groups but fair value is designated to meet a limited number of users interest. Another stated reason is that it doesn't require as much judgment so the information is easier to audit. One comment letter argued that companies don't anticipate profits under the historical cost model; it leaves thinking about the future to the investors and their models.

5.8 View's of Modifier's due to economic consequences opinion group

The Modifier's due to economic consequences group represents 4.1% of the whole 218 comment letters that were analyzed. Also, this opinion group represents the smallest percentage of the views that were represented in the pooled comment letters. These groups' opinions are spread throughout the main groups of users, preparers and academics. All these main groups have a couple of arguments in common. They all argue that fair value accounting is not the root cause of the financial crisis, but it has intensified the problem further. Specifically they argue that the fair value accounting is flawed because it requires companies to value their assets at fair value no matter what the markets conditions are. But ultimately they all agree that a suspension of fair value may deepen the already horrible economic conditions.

The users group listed different aspects of the current accounting treatments that can be improved. They mention that fair value accounting principles need to be tweaked and more adaptable to different economic conditions. Additionally, the provided guidelines and disclosures need to be increased as well as the use of good judgment during accounting need to be reemphasized. Also, possible solution to fair value accounting that was mentioned was to create a contra asset account that will grant the reporting of historical cost, or the change in the value of the asset that is causing the gain or loss for the company. In addition, it was proposed that the SEC should find a temporary solution to help the banks reevaluate their assets and then do not extend it once the crisis is over so that a close control on real asset value will be fairly disclosed in the financial reports. Patrick J Straka, an Chief Investment Officer and Economist of CIB, proposed to raise the meaning of liquidity risk premium used in determining a discount rate applied in the various Income Approaches using the present value models for deriving a fair market value. Academics on the other hand suggest that issues related to market participants influence over the valuation inputs need to be settled before fair value measurements can effectively increase financial transparency without unintended economic consequences. The preparers on the other hand, recommend that for the held-to-maturity securities the other than temporary impairment recognition be modified and be more closely aligned with the discounted cash flow guidance. All these proposals are coming from supporters of fair value with the desire for a modified set of fair accounting treatments.

In summary, we analyze the selected comment letter and try to find a relationship between the main and opinion groups. This relationship was examined through a table that was created by us while analyzing the subject area. At the same time it explains the different arguments that were used by the opinion groups. The next chapter we answer our research question and provide a prospective for future research.

6. CONCLUSION

This chapter answers our research questions. .

The purpose of this study is to gain understanding, through examination of comment letters of the current fair value debate during the financial crisis. The study in particular is interested in educating the reader about the different available opinions about the fair value debate within the financial crisis. Using a case study of comment letters, our purpose is to examine the debate about fair value in accounting which has arisen in the context of the current financial crisis.

> -What major perceptions can be found in the fair value debate?
> -What types of arguments can be found in the comment letters?
> -Is there any relationship between the main groups and the opinion groups in the different comment letters that were sent to FASB, IASB and SEC?

Specifically, this study is not trying to arrive at a general conclusion where thereafter the results can be applied to a sample of the population. This study rather tries to look into different opinion groups views behind the fair value debate within the current financial crisis and its main groups. We believe the most common argument used is that fair value accounting is dangerous to the economy and the financial stability. It is rare to find any argument relating to some kind of accounting theory or principles for measurement. As, the Accounting European Commissioner, Charlie McCreevy recently said:"Accounting is now far too important to be left solely to accountants!" He also said that EU finance ministers regarded the IASB as being "out of touch with today's reality" with an approach to standard setting which was too academic. We think our study of the comment letters confirms the view of accounting as more and more a subject to politics.

We believe there are surprisingly few "own arguments" in the debate. Especially, we think this aspect is more common to the different opinion groups that oppose fair value accounting. A lot of commentator's just state already existing and well known arguments on why fair value accounting is dangerous for the economy. For example, the alternatives (around half the total number of comment letters) provided maybe 5, 6 different arguments on why fair value accounting is dangerous and should be suspended and just 2 of them provided their own argumentation of what alternative accounting model or measurement basis should be used. We also find it surprising to just find 4.1% of the comment letters categorized as modifiers due to economic consequences. It seems like the different opinion groups supporting the fair value accounting concept, don't use economic reasons for their argumentation to the same extent as the different opponents groups do. For example, there are 23 Modifiers for other reasons but only 9 Modifiers due to economic consequences. Among the alternatives, nearly every comment letter argument is made with reference to economic consequences and financial stability.

In particular, the question in our study is whether the arguments in the opinion groups' reveal any relation to the main groups in the fair value accounting debate. According to our study, there seem to be some relationship between main groups and opinion groups. The users are the dominant main group among opponents, alternatives and irrelevant views. The preparers are the dominant main group among the public interest opinion group. Moreover, we were surprised that 50% of the auditors were strong supporters according to our flow chart study. One can think that auditors would prefer a historical cost accounting model since it should be a lot more difficult to audit fair values.

The major conclusion that can be drawn from the study is that there is no strong relationship between the main groups and the opinion groups. All the different opinion groups share the main view that fair value accounting needs improvements and major changes. These views and the expert debate can easily be looked at as a way to add to the already existing political pressures.

7. POSSIBILITIES FOR FUTURE RESEARCH

This chapter presents the possibilities for future research that arose while researching this topic.

Every time there is a crisis we can generally assume that politics will play a role in it. During this particular crisis it has become even more evident since the crisis escalated into a global one and every side has different views and opinions. So, with the political pressure in existence the fair value debate was not excluded from it. A good example of that is when the IASB came under pressure from the European Commission, as well as the French and German governments, to loosen up the IAS 39 standard (Anonymous, 2009). On the other hand, FASB was pressured by the Congress to relax the SFAS No. 157 standard on fair value and mark-to-market accounting (Anonymous, 2009). The pressure that is being exerted on the two standard-setting bodies leaves one wondering if in the near future the consequences will be more than we can bear. Could it lead to an un-leveled playing field as the Chairman of IASB Sir David Tweedie states (Anonymous, 2009)? Also, all the politics distracts us from the fact that the profession needs high quality improvements to the fair value accounting standards. Instead of focusing on the politics, one should put more energy into the improvement of the current situations within fair value.

One of the suggestions for improvements of the current problems with fair value came from Germany. The German's adopted a bank rescue plan that would be voluntary. This plan would allow a bank to set up its own bad bank. The word "bad bank" does not mean a real bank; it rather refers to a special purpose vehicle (SPV) or also sometimes referred to as companies where junk securities would be dumped (Münchau, 2009). In this particular plan troubled banks will be able to swap their toxic debt for government-backed bonds in return for paying an annual fee. These government-backed bonds will be given 90%t of the value of the toxic assets and they will be stored for up to 20 years (Ibid). The idea behind the bad bank is that these problem assets or toxic assets would be stored in those "bad banks" and frozen (BBC.com). So after the crisis these toxic assets would be re-evaluated if they can still be sold (Ibid). The main idea behind this plan is that banks would be given incentives to lend again and with that resolve the liquidity issues (Münchau, 2009). This particular proposal sounds interesting, but ultimately it should be further researched. It could be researched if this plan would work or if it would only be an accounting trick. Also, another potential research area could be if the bad bank plan from Germany could yield positive results and if it is possible to implement it in the United States. In conclusion, it is time to explore more alternative solutions to our problems instead of just playing a political game that only goes in circles with no potential prospects for a concrete solution.

APPENDIX

Comment Letters

	Commenter	Abbreviation	Date	Weblink
	Group: Preparers			
	II. Preparers - This group includes preparers, preparer-related professional organizations, and advisors to preparers.			
1	Allianz		2008-10-10	http://www.iasb.org/NR/rdonlyres/F319D7A3-5A83-4D61-B3AA-6F4AA1E426A8/0/10Allianz.pdf
2	Air France-KLM		2008-11-12	http://www.iasb.org/NR/rdonlyres/0539DEBA-0468-4DCA-B647-E83F004E421C/0/13AFKL.pdf
3	Association of Corporate Credit Union	ACCU	2008-10-28	http://sec.gov/comments/4-573/4573-87.pdf
4	BNP Paribas	BNP	2008-11-13	http://sec.gov/comments/4-573/4573-148.pdf
5	BridgePointe Advisors	BridgePoint	2008-11-13	http://sec.gov/comments/4-573/4573-161.htm
6	BridgePointe Advisors	BridgePoint	2008-11-13	http://sec.gov/comments/4-573/4573-156.htm
7	British Bankers' Association		2008-09-30	http://www.iasb.org/NR/rdonlyres/778064F3-6F5D-4176-A002-2C67AD8B0E3D/0/02BBA.pdf
8	Caisse d'Epargne		2008-10-02	http://www.iasb.org/NR/rdonlyres/9C906D33-9D5C-467B-9ABE-6AC2D38282BF/0/03CaissedEpargne.pdf
9	Cannon Company	Cannon	2008-11-13	http://sec.gov/comments/4-573/4573-162.htm
10	Citigroup	Citi	2008-11-12	http://sec.gov/comments/4-573/4573-128.pdf
11	Corporate One Federal Credit Union	Corporate One	2008-10-28	http://sec.gov/comments/4-573/4573-91.pdf
12	European Banking Federation		2008-10-03	http://www.iasb.org/NR/rdonlyres/1231F3B2-D144-4BD2-8AF1-348E3B376D75/0/07EBF.pdf
13	European Financial Services Roundtable		2008-10-13	http://www.iasb.org/NR/rdonlyres/961EFA43-349E-4CCA-B5EF-4A3284B7EC27/0/12EFR.pdf

14	European Insurance CFO Forum		2008-10-10	http://www.iasb.org/NR/rdonlyres/01F24592-0E62-4715-956C-DAA0822B227D/0/08CFOForum10Oct08.pdf
15	European Insurance CFO Forum		2008-10-30	http://www.iasb.org/NR/rdonlyres/D902C447-B122-4108-B86F-F4CEE29A68A6/0/09CFOForum30Oct08.pdf
16	Credit Suisse Group	Credit Suisse	2008-11-13	http://sec.gov/comments/4-573/4573-165.pdf
17	Eagle National Bank	Eagle	2008-10-01	http://sec.gov/comments/4-573/4573-37.pdf
18	Federal Home Loan Bank of Atlanta	FHLBA	2008-11-26	http://sec.gov/comments/4-573/4573-180.pdf
19	Federal Home Loan Bank of Chicago	FHLBC	2008-11-12	http://sec.gov/comments/4-573/4573-127.pdf
20	First Federal of Bucks County	Bucks County	2008-11-10	http://sec.gov/comments/4-573/4573-178.pdf
21	Highland Capital Management,	Highland	2008-10-23	http://sec.gov/comments/4-573/4573-58.pdf
22	Houlihan Lokey	Houlihan	2008-11-11	http://sec.gov/comments/4-573/4573-122.pdf
23	Institut der Wirtschaftsprüfer		2008-10-02	http://www.iasb.org/NR/rdonlyres/1D7D981B-9FB0-4E37-AFFA-F53292E3D064/0/05IDW2Oct08.pdf
24	Institut der Wirtschaftsprüfer		2008-10-27	http://www.iasb.org/NR/rdonlyres/D79A0448-6D1A-4A27-972B-1C0022372045/0/06IDW27Oct08.pdf
25	Integrated Planning Strategies, LLC	IPS	2008-10-30	http://sec.gov/comments/4-573/4573-104.pdf
26	Massachusetts Mutual Life Insurance Company	MassMutual	2008-11-13	http://sec.gov/comments/4-573/4573-155.pdf
27	MBIA, Inc.	MBIA	2008-11-13	http://sec.gov/comments/4-573/4573-167.pdf
28	Members United Corporate Federal Credit Union	Members United	2008-10-17	http://sec.gov/comments/4-573/4573-41.pdf
29	Nationwide Insurance Group	Nationwide	2008-11-13	http://sec.gov/comments/4-573/4573-157.pdf
30	Providence Health & Services	Providence	2008-11-10	http://sec.gov/comments/4-573/4573-143.pdf
31	Sleeping Bear Partners	Sleeping Bear	2008-10-01	http://sec.gov/comments/4-573/4573-18.pdf
32	Southwest Corporate Federal Credit Union	Southwest	2008-10-24	http://sec.gov/comments/4-573/4573-74.pdf
33	Square 1 Bank	Square 1	2008-10-08	http://sec.gov/comments/4-573/4573-70.pdf
34	SunCorp Corporate Credit Union	SunCorp	2008-10-27	http://sec.gov/comments/4-573/4573-80.pdf
35	SunCorp Corporate Credit Union	SunCorp	2008-11-12	http://sec.gov/comments/4-573/4573-133.pdf
36	U.S. Central	Central	2008-10-27	http://sec.gov/comments/4-573/4573-78.pdf
37	U.S. Central	Central	2008-11-13	http://sec.gov/comments/4-573/4573-152.pdf

38	Western Corporate Federal Credit Union	WesCorp	2008-10-24	http://sec.gov/comments/4-573/4573-73.pdf
39	Western Reserve Capital Management	Western	2008-07-25	http://sec.gov/comments/4-573/4573-171.pdf
40	Western Reserve Capital Management	Western	2008-09-25	http://sec.gov/comments/4-573/4573-172.pdf
41	Xylos Corporation	Xylos	2008-12-05	http://sec.gov/comments/4-573/4573-186.pdf
	Group: Auditors			
-				
	III. Auditors - This group includes auditors.			
42	Barret Peterson		2008-12-23	http://www.fasb.org/ocl/1201-UFM/53055.pdf
43	Frank Lasaracina		2008-12-23	http://www.fasb.org/ocl/1201-UFM/53056.pdf
44	Larissa R. Taylor		2008-12-28	http://www.fasb.org/ocl/1201-UFM/53160.pdf
45	PricewatherhouseCoopers LLP	PwC	2008-10-29	http://sec.gov/comments/4-573/4573-90.pdf
46	PricewatherhouseCoopers LLP	PwC	2008-10-01	http://sec.gov/comments/4-573/4573-1.pdf
	Group: Standard Setters			
	IV. Standard-Setters - This group includes standard-setters and related formal and informal advisory groups.			
47	Conseil National de la Comptabilité		2008-10-09	http://www.iasb.org/NR/rdonlyres/3268A22C-80F4-409B-A202-337588591844/0/04CNC.pdf
48	European Commission		2008-10-27	http://www.iasb.org/NR/rdonlyres/FD140082-0E3D-4683-95B0-E435D4798AC0/0/11EuropeanCommission.pdf
49	Financial Accounting Foundation	FAF	2008-10-02	http://sec.gov/comments/4-573/4573-84.pdf
50	Financial Accounting Foundation	FAF	2008-10-27	http://sec.gov/comments/4-573/4573-83.pdf
51	International Valuation Standards Committee	IVSC	2008-11-13	http://sec.gov/comments/4-573/4573-145.pdf
	Group: Academics			
	V. Academics - This group includes academics.			
52	Angel, James J.	Georgetown	2008-11-12	http://sec.gov/comments/4-573/4573-135.pdf

53	Columbia Business School	Columbia	2008-10-31	http://sec.gov/comments/4-573/4573-105.pdf
54	Gorton, Donald	Gorton	2008-10-28	http://sec.gov/comments/4-573/4573-89.htm
55	Grayson, Michael	Academic	2009-03-16	http://www.fasb.org/ocl/1201-UFM/53631.pdf
56	Landsman, Wayne R.	Landsman	2008-11-21	http://sec.gov/comments/4-573/4573-169.pdf
57	Ryan, John	Ryan	2008-10-28	http://sec.gov/comments/4-573/4573-81.pdf
58	Smith, David and Webinger, Mariah	UN-L	2008-11-13	http://sec.gov/comments/4-573/4573-149.htm
59	Waller, William Ph.D.	Waller	2008-10-23	http://sec.gov/comments/4-573/4573-62.htm
60	Wilson, Peter G.	Wilson	2008-10-29	http://sec.gov/comments/4-573/4573-94.pdf
	Group: Users			
	VI. Consultants - This group includes consulting firms engaged in, among other things, the use of fair value in financial reporting.			
61	BankLogic.Net, CPA's & Consultants	BankLogic	2008-11-03	http://sec.gov/comments/4-573/4573-126.pdf
62	Markit Group Limited	Markit	2008-11-12	http://sec.gov/comments/4-573/4573-123.pdf
63	New World Actuaries	New World	2008-11-13	http://sec.gov/comments/4-573/4573-137.htm
64	Partnership Consultants, Inc.	Partnership Consultants	2008-10-23	http://sec.gov/comments/4-573/4573-60.pdf
65	Towers Perrin	Towers	2008-11-13	http://sec.gov/comments/4-573/4573-164.pdf
	VII. Professional Organizations - This group includes accounting and finance professional organizations with broad-based membership, as well as informal professional groups.			
66	American Bankers Association	ABA	2008-11-13	http://sec.gov/comments/4-573/4573-158.pdf
67	American Bankers Association	ABA	2008-09-23	http://sec.gov/comments/4-573/4573-38.pdf
68	American Bankers Association	ABA	2008-10-13	http://sec.gov/comments/4-573/4573-19.pdf
69	American Council of Life Insurers	ACLI	2008-10-30	http://sec.gov/comments/4-573/4573-103.pdf
70	American Council of Life Insurers	ACLI	2008-11-13	http://sec.gov/comments/4-573/4573-153.pdf
71	American Institute of Certified Public Accountants	AICPA	2008-11-11	http://sec.gov/comments/4-573/4573-119.pdf

72	Appraisal Institute and American Society of Farm Managers and Rural Appraisers	AI/ASFMRA	2008-11-07	http://sec.gov/comments/4-573/4573-125.pdf
73	BAI CFO Roundtable	BAI	2008-12-03	http://sec.gov/comments/4-573/4573-194.pdf
74	C&J Valuation Advisors		2008-10-01	http://www.fasb.org/ocl/1201-UFM/52630.pdf
75	Capital Group Companies, Inc.		2008-05-21	http://www.fasb.org/ocl/1201-UFM/52081.pdf
76	Center for Audit Quality	CAQ	2008-11-13	http://sec.gov/comments/4-573/4573-151.pdf
77	Center for Audit Quality, CFA Institute, Consumer Federation of America, Council of Institutional America, Council of Institutional Investors, and Investment Management Association	Joint	2008-11-14	http://sec.gov/comments/4-573/4573-175.pdf
78	Center for Audit Quality, CFA Institute, Consumer Federation of America, Council of Institutional America, Council of Institutional Investors	Joint	2008-10-15	http://sec.gov/comments/4-573/4573-65.pdf
79	Center for Capital Markets Competitiveness	CCMC	2008-11-13	http://sec.gov/comments/4-573/4573-154.pdf
80	Center for Capital Markets Competitiveness	CCMC	2008-09-26	http://sec.gov/comments/4-573/4573-3.pdf
81	Center for Capital Markets Competitiveness	CCMC	2008-10-14	http://sec.gov/comments/4-573/4573-160.pdf
82	Center for Capital Markets Competitiveness	CCMC	2008-09-28	http://www.fasb.org/ocl/1201-UFM/52644.pdf
83	Commercial Mortgage Securities Association	CMSA	2008-10-22	http://sec.gov/comments/4-573/4573-64.pdf
84	Community Bankers Association of Illinois	CBAI	2008-10-08	http://sec.gov/comments/4-573/4573-98.pdf
85	Credit Union National Association	CUNA	2008-11-13	http://sec.gov/comments/4-573/4573-166.pdf
86	Financial Services Roundtable	Roundtable	2008-11-13	http://sec.gov/comments/4-573/4573-142.pdf
87	Independent Bankers Association of Texas	IBAT	2008-10-08	http://sec.gov/comments/4-573/4573-97.pdf
88	Independent Bankers of Colorado	IBC	2008-10-16	http://sec.gov/comments/4-573/4573-69.pdf
89	Independent Community Bankers of America	ICBA	2008-11-13	http://sec.gov/comments/4-573/4573-147.pdf
90	InFRE Retirement Resource Center	InFRE	2008-11-10	http://sec.gov/comments/4-573/4573-115.htm
91	Institute of Chartered Accountants in England and Wales	ICAEW	2008-11-13	http://sec.gov/comments/4-573/4573-146.pdf
92	International Corporate Governance Network	ICGN	2008-11-13	http://sec.gov/comments/4-573/4573-139.pdf
93	International Corporate Governance Network		2008-10-30	http://www.iasb.org/NR/rdonlyres/0D524FAC-29CF-42F7-BD24-4010BBAF7D60/0/14ICGN.pdf
94	Investment Adviser Association	IAA	2008-11-13	http://sec.gov/comments/4-573/4573-141.pdf
95	Investment Company Institute	ICI	2008-11-14	http://sec.gov/comments/4-573/4573-173.pdf
96	Missouri Independent Bankers Association	MIBA	2008-10-08	http://sec.gov/comments/4-573/4573-99.pdf
97	Mortgage Bankers Association	MBA	2008-11-13	http://sec.gov/comments/4-573/4573-140.pdf

98	National Association of State Boards of Accountancy	NASBA	2008-10-27	http://sec.gov/comments/4-573/4573-85.pdf
99	Pennsylvania Association of Community Bankers	PACB	2008-10-16	http://sec.gov/comments/4-573/4573-71.pdf
100	U.S. Chamber of Commerce, Financial Services Roundtable, Property Casualty Insurers Association of America, American Council of Life Insurers, Mortgage Bankers Association, and American Insurance Association	Joint II	2008-10-23	http://sec.gov/comments/4-573/4573-61.pdf
	VIII. Investor and Other Users - This group includes individual investors and other users, investor groups, investor protection agencies, and attorneys representing users.			
101	American Investor	American Investor	2008-10-09	http://sec.gov/comments/4-573/4573-7.htm
102	Anderson, Arthur T.	A. Anderson	2008-11-04	http://sec.gov/comments/4-573/4573-110.htm
103	Anderson, David V.	D. Anderson	2008-10-20	http://sec.gov/comments/4-573/4573-50.htm
104	Anderson, Marcia	User	2009-03-18	http://www.fasb.org/ocl/1201-UFM/53628.pdf
105	Anonymous Citizen	Anonymous	2008-11-12	http://sec.gov/comments/4-573/4573-130.htm
106	Anonymous Citizen	Anonymous II	2008-12-10	http://sec.gov/comments/4-573/4573-191.htm
107	Armstrong, Ronald	Armstrong	2008-09-30	http://sec.gov/comments/4-573/4573-33.htm
108	Baldwin, Timothy L.	Baldwin	2008-10-08	http://sec.gov/comments/4-573/4573-6.htm
109	Barr, Robert W.		2009-03-15	http://www.fasb.org/ocl/1201-UFM/53633.pdf
110	Benson, Robert	Benson	2008-11-12	http://sec.gov/comments/4-573/4573-124.htm
111	Bjork, Ruth A	Bjork	2008-11-11	http://sec.gov/comments/4-573/4573-120.htm
112	Black, John G.	Black	2008-10-28	http://sec.gov/comments/4-573/4573-77.htm
113	Boggio, Phillip H.		2008-12-31	http://www.fasb.org/ocl/1201-UFM/53370.pdf
114	Boone, Irene	Boone	2008-10-20	http://sec.gov/comments/4-573/4573-44.htm
115	Bucalo, MaryAnn	Bucalo	2008-11-07	http://sec.gov/comments/4-573/4573-163.htm
116	Carl	Carl	2008-10-22	http://sec.gov/comments/4-573/4573-56.htm
117	Carmony, John	Carmony	2008-10-09	http://sec.gov/comments/s7-26-08/s72608-93.htm
118	CFA Institute	CFA	2008-10-01	http://sec.gov/comments/4-573/4573-36.pdf
119	CFA Institute	CFA	2008-11-11	http://sec.gov/comments/4-573/4573-118.pdf
120	Ching, Hugh		2009-03-12	http://www.fasb.org/ocl/1201-UFM/53634.pdf
121	Cooper, Alan		2009-03-16	http://www.fasb.org/ocl/1201-UFM/53632.pdf

122	Council of Institutional Investors	CII	2008-10-29	http://sec.gov/comments/4-573/4573-95.pdf
123	Council of Institutional Investors	CII	2008-09-25	http://sec.gov/comments/4-573/4573-190.pdf
124	Cox, David	Cox	2008-10-28	http://sec.gov/comments/4-573/4573-86.htm
125	Cross, Jeffery	Cross	2008-10-06	http://sec.gov/comments/4-573/4573-5.htm
126	Davis, Kurt E.	Davis	2008-09-29	http://sec.gov/comments/4-573/4573-30.htm
127	DuPont, James M.	DuPont	2008-11-02	http://sec.gov/comments/4-573/4573-108.htm
128	Edgtton, Jason	Edgtton	2008-10-28	http://sec.gov/comments/4-573/4573-82.htm
129	Etheridge, Chris	Etheridge	2008-10-22	http://sec.gov/comments/4-573/4573-55.pdf
130	Evans, Onex P.	Evans	2008-10-28	http://sec.gov/comments/4-573/4573-72.pdf
131	Evans, Scott	Evans	2008-10-29	http://sec.gov/comments/4-573/4573-100.pdf
132	Fastiggi, Jason	Fastiggi	2008-10-29	http://sec.gov/comments/4-573/4573-93.htm
133	Fischer, Urs P.	Fischer	2008-11-06	http://sec.gov/comments/4-573/4573-113.htm
134	Foster, Marc	Foster	2008-10-25	http://sec.gov/comments/4-573/4573-76.htm
135	Fuller, Brian H.		2009-03-17	http://www.fasb.org/ocl/1201-UFM/53630.pdf
136	Gichini, Brittany	Gichini	2008-11-12	http://sec.gov/comments/4-573/4573-129.htm
137	Grossman, Steve	Grossman	2008-08-07	http://sec.gov/comments/4-573/4573-67.pdf
138	Gueye, Khadid	Gueye	2008-11-12	http://sec.gov/comments/4-573/4573-132.htm
139	Hale, Jon	Hale	2008-10-20	http://sec.gov/comments/4-573/4573-49.htm
140	Haley, Jay	Haley	2008-12-01	http://sec.gov/comments/4-573/4573-183.pdf
141	Hamilton, Alexandra	A. Hamilton	2008-12-02	http://sec.gov/comments/4-573/4573-181.htm
142	Hamilton, Stephen W.	Hamilton	2008-11-07	http://sec.gov/comments/4-573/4573-114.htm
143	Harmon, David	Harmon	2008-09-29	http://sec.gov/comments/4-573/4573-2.htm
144	Haslem, Mark	Haslem	2008-10-11	http://sec.gov/comments/4-573/4573-29.htm
145	Hazen, Steven	Hazen	2008-11-12	http://sec.gov/comments/4-573/4573-136.pdf
146	Hodge, David	Hodge	2008-10-09	http://sec.gov/comments/4-573/4573-9.htm
147	Investors Technical Advisory Committee	ITAC	2008-11-13	http://sec.gov/comments/4-573/4573-159.pdf
148	Investors Technical Advisory Committee	ITAC	2008-05-23	http://www.fasb.org/ocl/1201-UFM/52082.pdf
149	Isaac, William M.	Isaac	2008-10-29	http://sec.gov/comments/4-573/4573-79.pdf
150	Jackson, Rembert Pendleton		2009-03-17	http://www.fasb.org/ocl/1201-UFM/53629.pdf
151	Jeremiah, Roger W.	Jeremiah	2008-10-30	http://sec.gov/comments/4-573/4573-101.htm
152	Keating, Patrick	Keating	2008-09-30	http://sec.gov/comments/4-573/4573-35.htm
153	Kent, David W.	Kent	2008-10-11	http://sec.gov/comments/4-573/4573-15.htm
154	King, William	King	2008-10-13	http://sec.gov/comments/4-573/4573-16.htm
155	Knorr, Thomas L.	Knorr	2008-10-09	http://sec.gov/comments/4-573/4573-8.htm
156	Lane, Chris	C. Lane	2008-10-09	http://sec.gov/comments/4-573/4573-11.htm

157	Lane, Fred	F. Lane	2008-11-09	http://sec.gov/comments/4-573/4573-116.htm
158	Leavitt, Barbara	Leavitt	2008-10-20	http://sec.gov/comments/4-573/4573-47.htm
159	LeGuyader, Louis	LeGuyader	2008-10-09	http://sec.gov/comments/4-573/4573-27.htm
160	LeGuyader, Louis	LeGuyader	2008-09-28	http://sec.gov/comments/4-573/4573-31.htm
161	Levin, Douglas K.	Levin	2008-11-17	http://sec.gov/comments/4-573/4573-168.htm
162	Lofgreen, Shad	Lofgreen	2008-11-21	http://sec.gov/comments/4-573/4573-174.htm
163	Massey, Zara	Massey	2008-10-25	http://sec.gov/comments/4-573/4573-75.htm
164	McAllister, Teresa	T. McAllister	2008-11-10	http://sec.gov/comments/4-573/4573-117.htm
165	McAllister, Willis C.	W. McAllister	2008-10-09	http://sec.gov/comments/4-573/4573-66.pdf
166	Micheletti, Art	Micheletti	2008-10-15	http://sec.gov/comments/4-573/4573-21.htm
167	Miller, Jeffrey A.	Miller	2008-10-28	http://sec.gov/comments/4-573/4573-92.htm
168	Montroy, Vernon	Montroy	2008-10-24	http://sec.gov/comments/4-573/4573-57.htm
169	Morfesis, Alex G.	Morfesis	2008-10-28	http://sec.gov/comments/4-573/4573-88.htm
170	Murray, Lewis	Murray	2008-10-14	http://sec.gov/comments/4-573/4573-20.htm
171	Murray, Terry V.		2008-12-23	http://www.fasb.org/ocl/1201-UFM/53062.pdf
172	Napier, Jeff W.		2008-12-25	http://www.fasb.org/ocl/1201-UFM/53064.pdf
173	Nguyen, Dan J.	Nguyen	2008-11-23	http://sec.gov/comments/4-573/4573-177.htm
174	Oh, Lottie	Oh	2008-10-23	http://sec.gov/comments/4-573/4573-59.htm
175	Olson, Sue	Olson	2008-10-10	http://sec.gov/comments/4-573/4573-28.htm
176	O'Malley, Niall H.	O'Malley	2008-12-12	http://sec.gov/comments/4-573/4573-192.pdf
177	Owen, Daryle	Owen	2008-10-15	http://sec.gov/comments/4-573/4573-23.htm
178	Petersen, John L.	Petersen	2008-10-17	http://sec.gov/comments/4-573/4573-40.htm
179	Phillips, James E.	Phillips	2008-10-18	http://sec.gov/comments/4-573/4573-43.htm
180	Pierce, Steven	Pierce	2008-09-30	http://sec.gov/comments/4-573/4573-4.htm
181	Pigg, Gary L.	Pigg	2008-10-20	http://sec.gov/comments/4-573/4573-46.htm
182	Piper, Jason B.	Piper	2008-10-09	http://sec.gov/comments/4-573/4573-12.htm
183	Poweski, Mark	Poweski	2008-09-30	http://sec.gov/comments/4-573/4573-34.htm
184	Quigley, Peter	Poweski	2008-11-19	http://sec.gov/comments/4-573/4573-170.htm
185	Ramin, Kurt Paul	Ramin	2008-11-12	http://sec.gov/comments/4-573/4573-134.pdf
186	Raz, Sharon, Gutierrez, Isabel, Huesler, Lukas, and Dias, Roy	BUSL Students	2008-11-13	http://sec.gov/comments/4-573/4573-150.pdf
187	Rembert, Donald M.	Rembert	2008-11-25	http://sec.gov/comments/4-573/4573-179.pdf
188	Risgaard, David	Rembert	2008-12-08	http://sec.gov/comments/4-573/4573-188.htm
189	Rogers, Vincent	Rodgers	2008-12-04	http://sec.gov/comments/4-573/4573-185.htm
190	Rowley, Randy		2008-12-23	http://www.fasb.org/ocl/1201-UFM/53063.pdf

191	Saidens, Susan M.	Saidens	2008-10-22	http://sec.gov/comments/4-573/4573-53.htm
192	Schneider, Mark	Schneider	2008-12-08	http://sec.gov/comments/4-573/4573-187.htm
193	Schryer, Tom	Schryer	2008-10-31	http://sec.gov/comments/4-573/4573-106.htm
194	Schuler, Marcus	Schuler	2008-10-20	http://sec.gov/comments/4-573/4573-48.pdf
195	Sconyers, Richard	Sconyers	2008-12-02	http://sec.gov/comments/4-573/4573-182.htm
196	Sigmon, Michael	Sigmon	2008-10-22	http://sec.gov/comments/4-573/4573-54.htm
197	Smith, Gregory H.	Smith	2008-11-01	http://sec.gov/comments/4-573/4573-107.htm
198	Smith, Stephen T.	S. Smith	2008-11-11	http://sec.gov/comments/4-573/4573-121.htm
199	Spicer, Dave	Spicer	2008-11-04	http://sec.gov/comments/4-573/4573-109.htm
200	Steinbacher, Gunther	Steinbacher	2008-10-20	http://sec.gov/comments/4-573/4573-45.htm
201	Steinmetz, Charles T.	Steinmetz	2008-11-05	http://sec.gov/comments/4-573/4573-112.htm
202	Steward, Dan	Steward	2008-10-24	http://sec.gov/comments/4-573/4573-63.htm
203	Straka, Patrick J.	Straka	2008-12-03	http://sec.gov/comments/4-573/4573-184.htm
204	Strandt, W.	Strandt	2008-10-21	http://sec.gov/comments/4-573/4573-52.htm
205	Tarasuk, Brian H.	Tarasuk	2008-10-30	http://sec.gov/comments/4-573/4573-102.htm
206	Tchingambu, Delphine	Tchingambu	2008-11-12	http://sec.gov/comments/4-573/4573-131.htm
207	Urban, Walter	Urban	2008-11-13	http://sec.gov/comments/4-573/4573-138.pdf
209	Varley, Philip	Varley	2008-10-30	http://sec.gov/comments/4-573/4573-96.htm
210	Vetter, James	Vetter	2008-10-21	http://sec.gov/comments/4-573/4573-51.htm
211	Viets, Gilbert F.	Viets	2008-11-05	http://sec.gov/comments/4-573/4573-111.htm
212	Viets, Gilbert F.	Viets	2008-11-23	http://sec.gov/comments/4-573/4573-176.htm
213	Viets, Gilbert F.	Viets	2008-12-15	http://sec.gov/comments/4-573/4573-195.htm
214	von Kleist, Karsten	Kleist	2008-10-16	http://sec.gov/comments/4-573/4573-39.htm
215	Walker, Ray	Walker	2008-09-30	http://sec.gov/comments/4-573/4573-32.htm
216	Younger, Nancy	Younger	2008-10-02	http://sec.gov/comments/4-573/4573-22.htm
	IX. Securities Information Processors - This constituency includes organizations that provide quotation services for securities.			
217	Pink OTC Markets Inc.	Pink OTC	2008-10-02	http://sec.gov/comments/4-573/4573-193.pdf
	<u>Group: Other public</u>			
	I. Members of Congress - This group includes members of Congress.			
218	Bachus, Spencer	Bachus	2008-10-14	http://sec.gov/comments/4-573/4573-68.pdf

DEFINITIONS

Collateralized Debt Obligations (CDO’s):

CDO's, or Collateralized Debt Obligations, are sophisticated financial tools that repackage individual loans into a product that can be sold on the secondary market. These packages consist of auto loans, credit card debt, or corporate debt. They are called collateralized because they have some type of collateral behind them.

CDO's are called asset-backed commercial paper if the package consists of corporate debt and mortgage-backed securities if the loans are mortgages. If the mortgages are made to those with a less than prime credit history, they are called subprime mortgages.

CDO's were created to provide more liquidity in the economy. It allows banks and corporations to sell off debt, which frees up more capital to invest or loan. The creation of CDO's is one reason why the U.S. economy has been so robust in the last five years.

However, the downside of CDO's is that it allows the originators of the loans to avoid having to collect on them when they become due, since the loans are now owned by other investors. This may make them less disciplined in adhering to strict lending standards.

Another downside is that they are so complex that often the buyers aren't really sure what they are buying. They often rely on their trust of the bank selling the CDO without doing enough research to be sure the package is really worth the price.

The opaqueness and complexity of CDO's can cause a market panic if something happens to make sellers lose their trust in the product. This then makes the CDO's difficult to resell. This helped cause the 2007 Banking Liquidity Crisis.

(http://useconomy.about.com/od/glossary/g/CDOs.htm)

Synthetic CDO’s:

A synthetic CDO involves the issue of securities by an issuer (typically a special purpose company), the return on which is determined by reference to the performance of a portfolio of corporate loans or other similar debt obligations. The CDO is synthetic in the sense that the issuer need not hold the loan portfolio – there need not be a 'physical' portfolio of loans at all. The credit exposure – and return– is synthetically created by the issuer executing a credit default swap with a counterparty (typically the arranging bank) under which the counterparty pays the issuer a periodic (eg monthly) fee equivalent to an interest margin on a portfolio of notional loans made to publicly rated companies. In return, the issuer agrees to pay the counterparty principal losses if a company in the portfolio suffers a designated credit event (eg. Insolvency or default on its senior debt). The interest margin paid to the issuer generates part of the return to investors, enhancing their yield. If the portfolio suffers a principal loss, those losses flow through to investors (typically only once they reach an aggregate amount in excess of a first loss or 'protection amount'). In essence, the counterparty buys credit protection with respect to the portfolio of corporate loans. One of the great attractions for arrangers of synthetic CDOs is the ability to issue securities without actually owning any assets to back those securities. Essentially, they are able to look at investor demand and appetite for particular levels of risk and return, and create a synthetic asset, specifically tailored to meet investor demand.

(http://www.aar.com.au/pubs/pdf/itm/jun04.pdf)

Derivatives:

A security whose rice is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the underlying asset. The most common underlying assets include tocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage.

Investopedia explains *Derivative*

Futures contracts, forward contracts, options and swaps are the most common types of derivatives. Derivatives are contracts and can be used as an underlying asset. There are even derivatives based on weather data, such as the amount of rain or the number of sunny days in a particular region.

Derivatives are generally used as an instrument to hedge risk, but can also be used for speculative purposes. For example, a European investor purchasing shares of an American company off of an American exchange (using U.S. dollars to do so) would be exposed to exchange-rate risk while holding that stock. To hedge this risk, the investor could purchase currency futures to lock in a specified exchange rate for the future stock sale and currency conversion back into Euros.

(http://www.investopedia.com/terms/d/derivative.asp)

Embedded Derivatives:

A component of a hybrid security that is embedded in a non-derivative instrument. An embedded derivative can modify the cash flows of the host contract because the derivative can be related to an exchange rate, commodity price or some other variable which frequently changes. For example, a Canadian company might enter into a sales contract with a Chinese company, creating a host contract. If the contract is denominated in a foreign currency, such as the U.S. dollar, an embedded foreign currency derivative is created. According to the International Financial Reporting Standards (IFRS), the embedded derivative has to be separated from the host contract and accounted for separately unless the economic and risk characteristics of both the embedded derivative and host contract are closely related.

(http://www.investorwords.com/7138/embedded_derivative.html)

Toxic Assets:

An asset that becomes illiquid when its secondary market disappears. Toxic assets cannot be sold, as they are often guaranteed to lose money. The term "toxic asset" was coined in the financial crisis of 2008/09, in regards to mortgage-backed securities, collateralized debt obligations and credit default swaps, all of which could not be sold after they exposed their holders to massive losses.

Investopedia explains *Toxic Assets*

A toxic asset can be best described through an example:

If John Doe buys a house and takes out a $400,000 mortgage loan with a 5% interest rate through Bank A, the bank now holds an asset – a mortgage-backed security. Bank A is now entitled to sell the asset to another party (Bank B). Bank B, now the owner of an income-producing asset, is entitled to the 5% mortgage interest paid by John. As long as house prices go up and John continues to pay his mortgage, the asset is a good one.

If, however, John defaults on his mortgage, the owner of the mortgage (whether Bank A or Bank B) will no longer receive the payments to which it is entitled. Normally, the house would then be sold, but if the house price has declined in value, only a portion of the money can be regained. As a result, the securities based on this mortgage become unsellable, as no other party would pay for an asset that is guaranteed to lose money.

In this example, the mortgage-backed security becomes a toxic asset.

(http://www.investopedia.com/terms/t/toxic-assets.asp)

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