Submission to the SEC on "mark-to-market accounting"
File No. 4-573

Preliminary points:
The context for the evaluation needs to be broadened considerably.

1. S.133 of the EESA 2008 loosely equates "market-to-market accounting" with fair value accounting. In the sense that mark-to-market can be interpreted as reporting assets at their net current market selling prices, it is a different concept from reporting at fair value as prescribed in accounting standards. By the exclusion of transactions costs, and in its willingness to depart from the contractual sums arising from transactions, fair value is not an empirical concept and should be rejected. Moreover, in the development of fair value, the distinction between executed and executory contracts is overlooked. In fact, the lack of guidelines on what is trying to be achieved by mark-to-market (e.g. an underlying value or liquidity value or something else) makes it difficult to suggest what is the correct valuation, particularly in unstable markets or whether valuations in such circumstances serve a useful purpose. There is a need to go back to the fundamentals outlined below. Also, there needs to be greater consideration of the underlying legal responsibilities when securitisation occurs. If the corporation retains legal obligations, the securities should have remained on the books and should have been regularly monitored for possible bad debts and appropriate allowances made. To treat them as if the debtors, for example, have been sold and are no longer of interest to the company, may be a denial of the underlying legal facts.

2. Accounting standards boards have been misled by three fundamental errors. First, the shift in emphasis in financial accounting from reporting on periodic profit for a past period (including the related balance sheet) to the future orientated emphasis of providing information for the prediction of future net cash flows from the holding of shares (Trueblood Study Group, 1973). Secondly, the designation of financial statements as general purpose; and thirdly, by the apparent abandonment of the transaction basis to accounts (as to be found in historical cost properly applied) following the Savings and Loan crisis in the US. Blatant failure in that case to apply historical cost correctly was not a reason to abandon historical cost but rather justification for greater enforcement of correct application.

3. The need for a separate schedule of wealth showing assets and liabilities measured at their net current market selling (settling) prices (Joplin, 1915; quoted by Previtts and Merino, 1979: 181) overlooked in general purpose accounts for many years, has come to dominate the reporting process at the expense of consistent measurement of periodic profit. This is unfortunate as both the measurement of wealth using current market selling prices and of profit using actual transactions are urgently needed.

Submission - two recommendations:

1. Mark-to-market accounting, interpreted as measuring assets and liabilities at their net current market selling (settling) prices, should be used as the main measurement base in a new accounting statement; namely, a Schedule of Wealth including all assets and liabilities. Information needs for which this Wealth Schedule would provide relevant information are for the calculation of liquidity, and solvency of the entity,

and for the calculation of net exchangeable asset backing per equity share. The particular property being measured for these purposes is the "right of sale", and the relevant measure is the net realisable value.

2. Measurement of profit for a past period is for the twin purposes of money capital maintenance, and of stewardship of the money funds entrusted to the directors. As Alexander (1950: 78) wrote: "Under the trust fund theory of the capital of a corporation, .. the creditors are entitled to protection against reducing the value of the owner's equity below a stated amount, it is appropriate to use a money measure rather than a real measure of capital….It is clear from this point of view a money measure of capital is appropriate, since a claim fixed in money terms is being protected". The stewardship function has been well expressed by Edwards and Bell (1961: 271)in these terms: "...evaluation of management, or more broadly of the performance of the individual firm, by stock-holders, creditors (including banks), regulatory agencies of the Government and other interested outsiders... Evaluation by both insiders and interested outsiders provides the key to the successful functioning of a private, free enterprise economy." Furthermore, these authors favoured retention of the realisation principle so that profits are not anticipated. Investors and others are then able to use this information in their investment models or predictions. The information provides a necessary, first step to predicting future net cash flows. The property right underpinning these two information needs is "right of use, including sale, in the earning of profit". Profit, properly measured, represents an increase in property rights. Its measurement is secured by being based on transactions arising from executed contracts, contracts being the means by which property rights are changed.

Papers elaborating these views can be made available on request.

References:

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Previts, G.J. and B.D. Merino. 1979. *A History of Accounting in America.* John Wiley & Sons.

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