Make Accounting Regulators Accountable

The flawed valuation models for subprime securities have once again brought accounting issues to the forefront. In addition, mark-to-market accounting—which requires financial instruments such as loans to be valued at the price of an ill-defined "market"—has been blamed by both Democrats and Republicans for spreading the credit contagion from bad banks to good. Mark-to-market mandates have generated questions both about their accuracy and about their economic impact. They exaggerate losses by forcing financial institutions to write down performing loans based on another institution's fire sale even if the market for such loans is highly illiquid and the financial institution in question has no plans to sell the loans.

Underlying all these problems is the fact that there are relatively few checks on the accounting standards body that makes these rules: the Financial Accounting Standards Board (FASB). FASB is a private body, yet Congress requires public companies to support it through a type of tax—an accounting support fee. Moreover, federal regulatory agencies like the Securities and Exchange Commission and the Federal Deposit Insurance Corporation almost always defer to FASB in setting standards for everything from investor reports to solvency rules.

Earlier this decade, FASB greatly limited the use of employee stock options—which had bipartisan recognition for their effectiveness at spreading the wealth and creating more of it—by requiring companies to "expense"—that is, subtract the estimated value of stock options—from current earnings, even though stock options never result in a cash outflow. This policy has had little effect on levels of executive compensation, but has caused companies to greatly reduce stock options for rank-and-file workers. It has also resulted in misleading financial reports for investors of companies that utilize stock options, as companies are required to report phantom "losses" when there has been no money leaving the firm's coffers. Congress should:

- Require regulatory agencies to suspend mark-to-market accounting mandates such as Financial Accounting Standard 157 until better guidance is developed for illiquid markets.
- Reverse the options expensing standard (through legislation similar to previous bills that had bipartisan support, including that of Senate Majority Leader Harry Reid and Speaker Pelosi).
- Hold hearings to examine FASB's process of setting accounting standards and whether the agency should continue to have a de facto monopoly on setting those standards.

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