

The Next Shoe to Drop?

Jonathan Weil at Bloomberg has written a shorter but equally compelling piece that discusses the often arcane and incomprehensible world of bank asset valuation. In a well written and simple to read commentary, Mr. Weil notes that pending FASB accounting changes, which would require quarterly disclosure of bank assets' fair values (as opposed to historical values) could dramatically revise downward the value of bank loans on their balance sheets. In many cases, these downward valuations could effectively eliminate shareholder equity, and lead to technical insolvency for many of these banks. As Weil highlights, current FASB rules permit most banks to carry these loans on their balance sheets at historical cost under a complex regime that allows management great latitude in recognizing loan losses. Under the proposals, these loan losses would be immediately recognized and lead to lower earnings. Weil notes that the disparity between historical book values and fair market values is so great that many banks, including many of our largest institutions, might become technically insolvent, and shareholder equity destroyed.

This article dramatically underscores how easily manipulated our financial statements have become, and how even in-depth analysis of these statements by supposedly "sophisticated investors" is largely meaningless as a guidepost for prospective investment decisions. Without accurate and meaningful financial reporting, the numbers might as well be written in Cyrillic for all their purported value. This change is long overdue.

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