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Did Exit Pricing Under FASB 157 Contribute to the Subprime Mortgage Crisis?

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Abstract

The current financial crisis has revived the debate surrounding fair value accounting especially in the case of illiquid markets and for assets that lack marketability. Many analysts argue that it was issuance of FASB 157 (ASC 820) and the use of fair value accounting that caused the financial crisis to spread from the subprime mortgage market to the rest of the economy. The move by FASB to present all financial assets at fair market value is appropriate as this improves the reliability, relevance and transparency of the financial statements. Presenting assets at historical cost when unrealized losses are material is not proper financial reporting and distorts the current financial position of a firm. However, the exit price requirement under FASB 157 is too strict and results in an overly conservative financial presentation. The use of exit prices to define fair value was the problem, had a negative effect on the economy, and contributed to the financial crisis as it forced firms to overstate their losses. Instead of exit prices, the IFRS definition of fair market value should be adopted. The IFRS definition does not use entry or exit price but is an arm's length exchange price between unrelated parties.

Keywords: Fair-Value Accounting, FASB 157, ASC 820, IFRS Definition of Fair Value, Mark-to-Market, Subprime Mortgage Crisis**JEL Classification:** G10, G21, M41[Suggested Citation](#) >[Show Contact Information](#) >[Download This Paper \(Delivery.cfm/SSRN_ID1874157_code1332876.pdf?abstractid=1874157&mirid=1\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1874157_code1332876.pdf?abstractid=1874157&mirid=1)[Open PDF in Browser \(Delivery.cfm/SSRN_ID1874157_code1332876.pdf?abstractid=1874157&mirid=1&type=2\)](https://papers.ssrn.com/sol3/Delivery.cfm/SSRN_ID1874157_code1332876.pdf?abstractid=1874157&mirid=1&type=2)

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