Mark-to-market accounting

Business, Marketing

1) In mark to market accounting, a company values its financial assets and liabilities based on the prevailing market prices for that particular asset or liability. Mark to market treatment can also be done by valuing the asset or liability at the fair value of a similar asset or liability provided that the value has been assessed objectively. This accounting treatment gives a true representation of the asset or liability value at the balance sheet date whereas carrying such assets or liabilities on original cost might cause the closing book value to be reflected inaccurately. Another benefit for companies of using such accounting treatment is the recording of unrealized gain on mark to market of financial assets e. g. in the case of investment in shares, the unrealized gain would be the difference between the cost price of those shares and the market price of those shares on which it is currently being traded in the stock market.

2) For a mark to market accounting, it is very essential for trading to be in practice as the buyers and sellers are the two factors who determine the fair value of the assets and liabilities. In times financial crises trading is minimal and the markets are destabilized. The companies, during financial crises, have losses to report on in their P&L statements as the fair value of their assets has decreased below their cost price. Recording of such losses erodes the equity of companies which significantly reduces their asset holding capacity. Since every company in the economy practices mark to market accounting, the effect of economic downturn prevails throughout and the business cycle takes a downturn which causes further exacerbation. The banks and financial institution are affected the most as their balance sheet

comprises mostly of financial assets. As a result, bankruptcy, large- scale fire-sale of assets and layoffs takes place.

3) During financial turmoil, relaxation in the requirement of mark to market by the regulators can certainly be a boost for the companies facing financial difficulties. Instead of valuing the assets based on the fair value in the market, the company should be allowed to use their judgment in determining the value on which the asset should be recorded. When each company would be using its own pricing model based on its best judgment, the assets would appear at different values in the balance sheet of different companies. When companies hold different and contrasting views on certain things they trade which eventually becomes beneficial for the economy.