Derivatives and mark-to-market

Letters: 2002, 2008 · Difficulty: Advanced

> *"“Mark-to-market” then turned out to be truly “mark-to-myth.” ... Derivatives are financial weapons of mass destruction.” (2002)*

1. A derivative contract had a fair value of +$20 million at the start of the year and −$15 million at year-end. What gain (loss) is reported for the year ($ millions; use a minus sign for a loss)? _____

2. Why are many derivatives hard to audit?

   A. They are recorded at historical cost

   B. With no active market, fair value comes from management's models and assumptions

   C. Derivatives are never recorded on the balance sheet

   D. They are always worth zero

Source: Warren E. Buffett, Letters to Berkshire Hathaway Shareholders: 2002, 2008 (berkshirehathaway.com/letters). Quotation © Berkshire Hathaway Inc., all rights reserved; quoted for non-commercial teaching. Numbers in the questions are made up unless stated.