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LETTER OF COMMENT NO. 8

1 April 2009

The Financial Crisis Advisory Group
C/- Mr Adam Van Eperen
The Financial Accounting Standards Board

Copy by email: ajvaneperen@fasb.org

Dear Mr Van Eperen

RESPONSE TO FINANCIAL CRISIS ADVISORY GROUP QUESTIONS

Please find attached the Securities Commission's submission on the Financial Crisis Advisory Board (FCAG) questions.

We are in unusual times with the current financial crisis and market turmoil. It is important that any financial reporting standards developed now are robust and sustainable for all future market conditions, not just developed to address problems experienced in the past.

The critical matters that the IASB and FASB should work on to ensure a globally consistent approach are:

- a) accounting for off-balance sheet items; and
- b) financial instruments, including complexity of reporting and issues of fair value.

We note that the IASB has just released an exposure draft of proposals to improve the derecognition requirements for financial instruments. We congratulate the IASB on their acceleration of this issue in light of the crisis.

While we acknowledge work underway by the IASB to reduce complexity in accounting for financial instruments we strongly urge the FASB to work with the IASB to simplify accounting in this area.

Yours sincerely

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Chairman

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Submission by the New Zealand Securities Commission on the FCAG Questions

Comments on the Questions

1. From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.

In our view accounting did not cause the crisis nor has it created unnecessary concerns, although there is a perception that this is the case.

Information in general purpose financial reports should faithfully reflect economic reality. Any changes to financial reporting standards should not undermine this aim.

General purpose financial reporting (GPFR) has helped identify issues of concern through the requirements to account for impairment and fair value requirements which help ensure that financial statements reflect economic reality. We note there have been some concerns expressed about the reliability of some measurements used in GPFR. We also note that in GPFR there is sometimes a trade-off between relevance and reliability (i.e. faithful representation). When information is relevant it should be provided, accompanied if necessary by added disclosure about the measurement basis.

2. If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.

The additional loan provisions that are the subject of the question differ from current IFRS and US GAAP requirements which aim to reflect current economic reality with regard to loan value. Additional provisioning in 'good times' to provide a buffer for 'bad times' may be prudent, and if necessary, the Commission's view is that option (3) is the appropriate way to reflect the additional provisions. Any such prudential reserve should not be created or reduced by adjusting profit or loss. We do not support options (1) and (2).

Any prudential reserve must be transparently clear to investors. The financial statements should clearly disclose amounts put into any prudential reserve and amounts transferred out of the reserve.

It is likely that there are differing approaches to the application of the IFRS "incurred loss" model. Therefore better guidance on its application is probably necessary.

3. Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitisations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?

Yes we believe that off-balance sheet items are very important areas that have featured in the crisis and need to be addressed. Therefore the IASB and FASB should improve the accounting requirements as soon as possible. Improvements should ensure that US GAAP and IFRS are consistent and work to this end should be completed with urgency.

We note that work is already advanced on projects dealing with consolidation and derecognition, including the release by the IASB on the 31 March 2009 of an exposure draft of proposals to improve the derecognition requirements for financial instruments. We congratulate the IASB on their acceleration of this issue in light of the crisis. The Commission will look to make a submission on this document in due course.

4. Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as an interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

It is unrealistic to move to a full fair value model for all financial instruments at the moment. Therefore we support a mixed attributes model. However, we believe that the rules surrounding accounting for financial instruments need to be simplified. Too many rules make it difficult to discern any underlying principles and are confusing for preparers and users of financial statements. Also there is likely to be a greater risk of the mis-application of GAAP/IFRS if the rules are very complex and only really understandable by specialist accounting experts.

Reducing the number of financial instrument classes and simplifying the hedge accounting rules would be ways to reduce the complexity.

We acknowledge work underway by the IASB to reduce complexity in this area and strongly urge the FASB to work with the IASB to simplify accounting for financial instruments.

5. What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

Ideally standard setting should not be undertaken in response to an emergency and should involve suitable consultation with constituents. However, we acknowledge that there is a

balance to be achieved and that on occasions the IASB, as with any standard setter, may have to resolve an “emergency issue”.

We strongly believe that where the IASB has an “emergency issue” requiring a timely response that this should always be tested against an independent body that can give assurance to the standard setter that the issue qualifies for fast-tracking. The independent body that we believe could offer this assurance is the IASB Monitoring Board.

Possible criteria that accounting standard-setters might consider in determining whether an issue is an ‘emergency’ could be:

- Is there a “loophole” or “failure” in a standard, which if not fixed immediately in the current environment, may lead to misleading or inappropriate financial reporting?
- Are the current market conditions such that the disclosure requirements in a particular area are totally inadequate such that users will be ill-informed or misled?

If an emergency did arise then at the very least seeking input and comment from respected and qualified selected persons or groups is preferred to no consultation at all – bearing in mind that resorting to such measures has reputation risk for the standard setter.

There are two particular points we wish to note:

1. In the Commission’s view standard setters need to be cognisant that international standards are adopted into law and regulation of countries worldwide. Normally the adoption of law or regulation requires that there be appropriate due process. The setting of standards in an “emergency” will probably not fully fit the legal requirements for due process.
2. Care also needs to be taken in setting implementation dates for standards. Generally legislators will not endorse retrospective regulation. Therefore it is preferable if standards are issued in an “emergency” that the standard is issued with a suitable near future implementation date but allowing early adoption of the standard.

The Commission believes that the IASB and FASB need to be sensitive to these 2 issues.

6. Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organisations? If so, which issues and why, and which organisations?

Prudential standard setters, such as the Basel Committee on Banking Supervision, have a role and a set of tools available to them to address some of the issues that are being discussed. In terms of the call for “dynamic provisioning” we believe that the rules for this need to be set by prudential regulators. However, in the Commission’s view if any such provisioning is introduced to general purpose financial reports then it should only operate in accordance with option (3) that was outlined under FICAG’s Question 2.

Otherwise we have no particular comments to make.

7. Is there any other input that you'd like to convey to the FCAG?

We have no further comments to make.