



Memo

IASB-FASB Financial Crisis Advisory Group (c/o ajvaneperen@fasb.org) To:

Accounting Standards Board – Canada, Staff From:

Date: April 2, 2009

Re: **Financial Crisis Advisory Group Request for Comments**

The following comprises the response of the staff of the Canadian Accounting Standards Board (AcSB) to the request, dated March 10, 2009, for comments to assist the Financial Crisis Advisory Group (FCAG) in discussing accounting and reporting matters related to the financial crisis and making recommendations thereon to the IASB and the FASB.

Overall, we support careful consideration as to whether improvements to financial reporting standards are necessary as a result of the current financial crisis. However, we caution that stakeholders have limited tolerance for multiple changes to accounting standards and that attempting "quick fixes" through "fast-track" standard-setting is rarely successful. For example, the reaction to the IASB's changes last year to allow reclassification of some financial assets has been largely negative, both regarding the process undertaken and the eventual accounting results. Similarly, the IASB & FASB's attempts, in early 2009, to introduce disclosures regarding impairment losses did not find sufficient support, being viewed by many as partial solutions, compiled in a rush. Recently proposed FASB staff positions regarding fair value measurement and other-than-temporary impairments also are drawing extensive criticism from many quarters.

First, we think that, rather than piecemeal responses to perceived "urgent" issues, what is needed is for the IASB and FASB to determine a clear strategy for accounting for financial instruments and the use of current value measures, followed by movement to implement that strategy. Partial approaches not only introduce more "rules" and complexity, but also risk undermining the fundamental principles on which the current standards are based. Second, we think that any proposed changes to accounting standards need to be subject to adequate due process. Without attention to these two issues there is a great risk of damaging the overall credibility of the standard-setting process.

Our responses to each of the questions asked by the FCAG are detailed below.

We would be pleased to elaborate on these points in more detail if you require. If so, please contact Peter Martin, Director Accounting Standards at +1 416 204-3276 (e-mail peter.martin@cica.ca) or Ian Hague, Principal at +1 416 204-3270 (e-mail ian.hague@cica.ca).

Responses to Questions asked by FCAG

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.

Overall, we think that general purpose financial reporting has stood up reasonably well in the current financial crisis. The role of financial reporting is to provide relevant information that faithfully represents the underlying economic circumstances, in order that users can make informed decisions on a timely basis. An important quality of financial information is neutrality. Accounting standards should not be designed to bias decisions or outcomes in any particular way. Moreover, accounting standards for individual entities are not an appropriate mechanism to influence macroeconomic objectives such as to achieve long-term financial stability. We note that many other commentators have expressed these same views.

Many criticize the use of *fair values*. However, in the current economic environment, fair values have helped identify areas of concern to investors and regulators. The very outcry about the information suggests that this information is of importance and of use. Fair value reflects changes in economic conditions, including liquidity; thus recognizing the effects of changes in economic conditions in the periods in which those changes occur. Fair value is not suitable in all circumstances and guidance on the determination of fair values can be enhanced in light of experience (see our response to question 4, below). However, in many circumstances fair value measurement is the only way in which underlying economic effects can be faithfully reflected in financial statements.

We think that there are two primary areas where accounting standards could have been enhanced. First, the lack of a comprehensive standard in IFRSs dealing with *how to determine fair values* is a significant shortfall—but one that the IASB is in the process of remedying. Second, the myriad of *impairment* standards has made it unduly confusing to understand the effects of the financial crisis on financial reporting. The existing variety of standards can produce dramatically different, but seemingly arbitrary results. A consistent, converged approach to impairment would be a significant step forward.

In addition to these two primary areas, the complexity of the financial reporting requirements for *financial instruments* is a challenge; though it is harder to see a solution (see our response to question 4, below).

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 objective of general purpose financial reporting, as laid out in the conceptual frameworks, is to provide decision-useful financial information about an entity to external parties, primarily investors and creditors. To be useful, information must reflect faithfully the economic events and circumstances affecting an entity. The purpose of the statement of financial position and statement of comprehensive income is to present the entity's position at the financial reporting date and for the period to that date. Therefore, we think that these statements should not be affected by additional provisions that do not reflect current losses, which is our understanding of what is meant by 'through-the-cycle' or 'dynamic' loan provisions.

There is nothing in today's standards to prevent an entity from making an appropriation of equity outside of comprehensive income, or from providing disclosures. The question is whether that should be required, and if so, on what basis. IFRSs today require disclosure of capital requirements imposed by regulators. A similar disclosure could be incorporated into IFRSs and FASB standards to require disclosure in the notes to the financial statements of any loan loss provision on a basis required by regulators. When there are any such externally imposed requirements, we think that they should be clearly presented in financial statements.

We think it important that any appropriation of equity or disclosure reflect the requirements of external regulation or legislation. It is important to note that an accounting appropriation does not, in of itself, create any extra cash or other safeguard to provide a buffer against future losses. However, when that appropriation reflects external regulation or legislation it is tied to additional restrictions requiring the entity to maintain capital or refrain from making distributions, and therefore provides useful information. An appropriation that is not tied to external regulation of legislation is no more than a journal entry, although that might provide information regarding the entity's intent, and possible change in intent if that appropriation is reversed.

We note that one means by which to reflect market expectations of future losses is to measure loans at fair values. However, many do not wish to do that, and advocate partial fair value approaches—such as adjustments for credit losses, but not for other value changes. These partial solutions might be linked to fair value, or might be based on the entity's expectations, rather than market-based expectations. Such partial approaches come with a price in terms of complexity—a price that needs to be carefully weighed against the benefits.

We would strongly object to any presentation that purports to show alternative measures of income in the financial statements (whether on the face of the statements or in a note). We think this would only confuse users as to the GAAP net income. Any alternative measure is, by definition, a non-GAAP measure and should not be included in the financial statements...

In summary, we strongly disagree with reflecting any difference between regulatory and current GAAP requirements in profit or loss (earnings), or in other comprehensive income. Such a difference is properly reflected by an appropriation of equity outside of comprehensive income or by footnote disclosure.

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?

We think that issues surrounding accounting for off-balance sheet items have not contributed significantly to the financial crisis in Canada. Beyond the effects of problems in other markets, the principal issue in Canadian financial markets has been a lack of transparency about some investments. However, we support the work being done by the boards to improve accounting for Consolidated Financial Statements, Derecognition of Financial Assets, Post-Retirement Benefits, and Leases.

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?

Our views on accounting and reporting of financial instruments are set out more fully in our response to the IASB's March 2008 Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*. The key points of that response are:

- We are generally supportive of fair value, appropriately defined, as the long-term solution for financial instruments where fair value is practicable of reliable estimation. However, we agree that more work needs to be done to define fair value and to explain how to determine fair values of some financial instruments in some situations. Provision is also needed for appropriate recognition and measurement when reliable fair value estimation may not be practicable.
- We think it important that the long-term goal be established and that only then should the need for any intermediate steps be considered, commensurate with that goal. We think that any intermediate changes to financial instruments accounting must be significant steps towards that long term goal. Tinkering with the details will achieve little and will frustrate stakeholders.
- 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?

We think that the accounting standards system is not intended for, and should not be modified to attempt to deal with, "urgent" issues. There is no substitute for consultation with stakeholders. Such consultation should never be passed over completely, and should be abbreviated only in extreme circumstances, after consultation with bodies charged with oversight of the standards-setting process (the Trustees). The Trustees must be satisfied that a

case has been made that an abbreviated process is essential for the overall good of financial reporting.

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?

We think that any requirements for additional loan loss provisioning need to be dealt with by prudential regulators. Standards setters can then assess the implications of those requirements for financial reporting.

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

None at this time.