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#### COMMENT LETTER

To

Date

Financial Crisis Advisory Group c/o Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk 2 April, 2009

Connecticut 06856-5116



By email: ajvaneperen@fasb.org

LETTER OF COMMENT NO.



Dear Sir

## Financial Crisis Advisory Group (FCAG) - request for input from constituents

We are pleased to comment, on behalf of BDO International<sup>1</sup>, on questions raised by the FCAG, which have been posted on the International Accounting Standards Board's website. Our comments are set out in the attached Appendix.

Please contact Wayne Kolins at +1 212 885 8595 or Andrew Buchanan at +44(0)20 7893 3300 if there are any aspects of our comments that you would like to discuss.

Yours faithfully,

BDO Global Coordination B.V.

<sup>&</sup>lt;sup>1</sup> BDO International is a world wide network of public accounting firms, called BDO Member Firms, serving international clients. Each BDO Member Firm is an independent legal entity in its own country.

The network is coordinated by BDO Global Coordination B.V., incorporated in the Netherlands, with an office in Brussels, Belgium, where the International Executive Office is located.

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### Question 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.

We believe that financial reporting has played a critically important role in identifying the consequences of flawed business models, and declines in asset values, at an early stage. Although the losses associated with fair value measurement (for derivative contracts and traded financial assets in particular), have been unpopular for some, they resulted in corrective action being taken sooner than if amortised cost measurement had been used. The extent of disclosures for financial instruments has also been enhanced in recent years, which has assisted in highlighting where issues might arise in future (such as liquidity analyses showing long term mortgage debt funded by short term funding).

Regulatory capital requirements and the needs of regulators, on which we comment below, have been put under pressure by write downs in the carrying values of financial assets by entities in the financial sector. While it is right that financial statements have reflected those losses, we suggest that the FCAG acknowledges the issues arising in relation to regulatory capital requirements, while at the same time emphasising the need for transparency and consistency in financial reporting.

We believe that the financial crisis has demonstrated clearly the need for one global set of high quality accounting standards. The amendment to IAS 39 which was issued by the International Accounting Standards Board (IASB) in October 2008 illustrated the potential risk of accounting arbitrage when there are multiple sets of accounting standards.

We note that the Financial Accounting Standards Board (FASB) has recently issued for comment a Staff Position (FSP-157e) 'Determining Whether a Market Is Not Active and a Transaction Is Not Distressed'. While we believe it would be appropriate to reconsider guidance for the point at which a market becomes illiquid or distressed, our response to the FASB notes that we disagree with the proposals set out in the FSP because we believe they would detract from the quality of financial reporting and would be likely to reduce consistency. We are strongly of the view that the proposals should not be published as drafted. It would be helpful for the FCAG to consider fair value measurement in general, as well as in the context of the FSP (which, if approved by the FASB, will likely have been issued in final form before the FCAG's meeting to be held on 20 April).

#### Question 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.

We believe that the needs of investors and other providers of capital, who need transparency in financial reporting including the reporting of profits and losses as they arise, and those of regulators, who have an interest in longer term capital stability, are different and should not be confused. We would strongly object to the inclusion of 'through the cycle' loan provisions in an entity's income statement or statement of other comprehensive income. We note that the inclusion of such provisions within profit or loss, or other comprehensive income, could result in losses

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being recognised in reported results for loans which do not currently exist but are expected to be originated in the future.

However, we would not object to an allocation being made to a specific reserve within equity, provided that this was only by way of a transfer between reserves and that there was full and comprehensive note disclosure. This disclosure would need to include a clear and transparent reconciliation between amounts reported in the financial statements in accordance with accounting standards, and any regulatory reserves transfer. In this way, the needs of investors and other providers of capital would not be prejudiced, while regulators could see clearly the extent to which capital had (or had not) been set aside in 'good times' to provide a buffer against losses to be incurred in a future economic downturn.

As noted in our response to question 7, we believe that the IASB and FASB need jointly to revisit the impairment requirements of IFRS and US GAAP as a priority joint project, with full consultation and due process. It will be appropriate for the IASB and FASB to liaise with prudential regulators during the course of this project, in order that the prudential regulators have clarity over the accounting requirements. This would assist in ensuring that any regulatory capital adjustments to amounts reported in financial statements are made on a consistent basis among different jurisdictions.

#### Question 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?

In our view, the financial crisis was caused primarily by failed business models. As noted above, accounting standards played a critically important role in exposing the consequences of those failed business models, including declines in asset values, at an early stage.

We note that there are significant differences between IFRS and US GAAP, both in respect of the consolidation models followed and the extent to which disclosures are required, and that the issue may be more significant where entities report in accordance with US GAAP.

The comment period in respect of the IASB's proposals for a revised consolidations standard has closed recently. We note that this is not a joint project with the FASB. As set out in our comment letter to the IASB, we disagree with certain of the principal proposals set out in the Exposure Draft. We suggest that the two Boards work together to enhance the requirements of both IFRS and US GAAP in this area and to ensure that there is consistency in both sets of guidance, such that the potential for accounting arbitrage is, so far as possible, eliminated.

### Question 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

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support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

While the reporting of all financial instruments at fair value may be an appropriate long term goal, we believe that there are significant issues which need to be addressed before this point will be reached. Consequently, we believe that a refined and simplified mixed attributes model would be the appropriate approach at this stage, with a further move toward full fair value accounting being deferred pending resolution of those issues.

For the purposes of a simplified mixed attributes model, the Boards should pursue the following in particular:

- A reduction in the categories of financial instrument to two, being fair value (with changes in value recorded in the income statement) and amortised cost;
- An enhanced impairment model (see section 7 below);
- Additional fair value measurement guidance, in particular in determining when a market has become inactive or prices distressed; and
- A simplified hedge accounting model (in particular for hedge effectiveness testing).

Improvements that would be required before we would support fair value measurement for all financial instruments include the following:

- The effect of fair value measurement on the carrying value of an entity's own debt is a key consideration if fair value measurement is to be applied to all financial instruments. We note that if this approach were to be followed, a decline in credit standing of an entity would result in a reduction in fair value of its own debt and credit to the income statement. Whilst this might be addressed by requiring specific disclosure on the face of the income statement, some might question the relevance of the effect of a fair value adjustment to an entity's own debt on its reported results. Although an exception to fair value measurement might be viewed as being attractive for an entity's own debt, we note that one of the criticisms of existing guidance is its complexity, which in part is due to the introduction of exceptions;
- How fair value measurement can be accommodated within an entity's separate financial statements.

#### **Question 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?

There is a need to balance consideration of the actual urgency of the issue against any compressed consultation period and the associated risk of unintended consequences of changes that might be made, and how entities would deal with changes introduced to their financial reporting. We suggest that the following considerations are relevant:

- The actual urgency of the issue
- The extent of change required to existing accounting standards in order to deal with the issue
- Whether the change will eliminate or reduce a GAAP difference
- The effect of the change on the quality of financial reporting
- The consequences of, and the effect on, the quality of financial reporting if the 'emergency issue' is not dealt with

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- The degree of difficulty for entities in dealing with changes that could arise in their financial statements
- The auditability of the financial statements
- The need for standard setters to have consulted widely about any proposed changes, and to be seen to be independent of third party pressure

### Question 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 note the increasing interest shown in accounting standards by government bodies. In that context, we believe that accounting standard setters might coordinate more closely with global bodies such as the Financial Stability Forum. This might assist in reducing the extent to which pressure might be brought to bear on new and modified accounting standards that might be issued in the future.

#### Question 7

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

Linked to our comments above in respect of the interest shown in accounting standard setting by governmental bodies, the FCAG should consider the extent to which, and how, it might emphasise the need for the accounting standard setting process to be independent and free from external influence.

Impairment of financial assets was discussed at the recent joint IASB/FASB Board meeting. We consider that the two Boards need to revisit impairment jointly, as a matter of priority, and consider how the existing model could be improved. This might involve revisiting and refining the existing incurred loss model; it may also be appropriate to explore the relative merits of an expected loss model.

Other aspects relating to impairment which might be considered include whether charges for assets held at amortised cost should include changes in market risk (in particular discount rates) in order to enhance consistency of measurement between categories of financial asset, and the approach to be followed for the recognition of reversals of previously recorded impairments (for both debt and equity instruments).