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By email: ayvaneperen@fasb.org

LETTER OF COMMENT NO. 70

2 April 2009

Dear Mr Van Eperen

FINANCIAL CRISIS ADVISORY GROUP: REQUEST FOR INPUT

The Institute's Accounting Standards Committee is pleased to respond to the questions raised by the Financial Crisis Advisory Group on accounting and reporting matters in relation to the financial crisis.

The Institute is the first incorporated professional accountancy body in the world. The Institute's Charter requires the Accounting Standards Committee to act primarily in the public interest, and our responses to consultations are therefore intended to place the general public interest first. Our Charter also requires us to represent our members' views and protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

General comments

We strongly support the work of the IASB as it develops high quality global financial reporting standards that reflect the underlying economic reality. The IASB is an independent body charged with developing accounting standards for general financial reporting. It should (and does) consult interested parties, including government departments and regulators. It must ensure that its responds to all relevant issues, without emphasising matters that only affect parties with particular interests. If economic reality is volatile, financial reporting should reflect this fact. We strongly believe that accounting has not caused the present economic crisis and it should not become the scapegoat for failures in other areas.

Our responses to the questions are set out below.

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?

Fair value accounting for financial instruments has helped highlight the extent of the problems in the financial markets — without this, banks and other entities would have been able to obscure their losses for a prolonged period. Accounting has been accused of exacerbating the pro-cyclicality of the financial markets, but we believe that it has in fact merely reflected the underlying economic volatility rather than contributing to it.

We believe that where general purpose financial reporting has not helped is in the overall length and complexity of corporate reports. In many cases, the volume and level of detail of disclosures both in the financial statements and in other sections of the annual report are such that the key information and risks are obscured, and overall, the corporate report does not tell a clear story about the entity's performance. In addition, reports are so long and complex that they become less useful to investors and other users and therefore the most important information is not identified when reading the reports. This may have caused concerns in that corporate reports are not as transparent or user-friendly as they could be.

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.

If prudential regulators were to require some form of 'through-the-cycle' or dynamic loan provisioning we would support option 3 above i.e. being reflected in the financial statements as an appropriation of equity outside of comprehensive income with appropriate note disclosures. This would promote transparency for investors and other users as funds set aside for regulatory purposes should not impact on net income or net assets.

3. Some FCAG members have indicated that they believe issues surrounding accounting for off-balance sheet 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?

First and foremost, we do not believe that accounting has been a primary contributor to the financial crisis – it is a language that has attempted to explain the underlying economic reality. We do not believe that the accounting for off-balance sheet items or fair value accounting have contributed to the financial crisis – rather it is the underlying structures and transactions, the risks attached to which were not fully understood or communicated, which were the source of the crisis. In general, we think that the accounting requirements in these areas have been adequate – in some cases the requirements may not have been applied properly, but this is a different issue. As we noted in our response to ED 10 on consolidated financial statements we are not convinced that the new proposals will be an improvement on the existing standards and believe that further work is required in this area.

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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?

Ultimately, a full fair value model for financial instruments is desirable as a long-term goal which would significantly reduce complexity in reporting financial instruments. This model would have to be developed in conjunction with a new model of financial statement presentation which would permit a meaningful presentation of changes in the value of financial instruments. Because of this, and due to the fact that many constituents of the IASB still favour a mixed attributes model, we recognise that it will take some time to move towards this position. As an interim measure, there is scope for some simplification of the existing financial instruments standards, for example, the model adopted in the draft IFRS for NPAEs could be adopted – reducing the current 4 categories of financial instruments to just two – fair value and held-to-maturity.

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?

IASB needs to be able to respond appropriately to any genuine emergency issues, but such issues should be extremely rare. These issues will be, by their nature, unexpected and unpredictable therefore attempts to place too many rules or processes around this may be ineffective. The IASB should make arrangements so that a group of constituents can be called on at short notice to review and provide input on any emergency issues, so that there is still a necessary element of stakeholder consultation.

6. Are there financial crisis-related issues that the LASB 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?

There have been a number of calls for the IASB to address financial stability as part of its remit in setting financial reporting standards. We strongly disagree with this proposal and believe that financial stability is the responsibility of prudential regulators. The aim of financial reporting is to provide transparent information to users in order to assist them in assessing stewardship and in decision-making. Building in a financial stability objective would conflict with this aim since financial statements need to portray a transparent picture of the underlying economic reality – if volatility is present; it is the job of financial reporting to reflect this.

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

There is no other input that we would like to convey at this time.

I hope our comments are useful to you – please do not hesitate to contact me if you wish to discuss them further.

Yours sincerely

AMY HUTCHINSON

Assistant Director, Accounting and Auditing Secretary to the Accounting Standards Committee

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