



Deloitte Touche Tohmatsu  
2 New Street Square  
London  
EC4A 3BZ  
United Kingdom  
Tel: +44 20 7007 0907  
Fax: +44 20 7007 0158  
www.deloitte.com  
kwild@fdeloitte.co.uk

Messrs Harvey Goldschmid and Hans Hoogervorst, Co-Chairmen  
Financial Crisis Advisory Group  
401 Merritt 7  
P.O. Box 5116  
Norwalk, Connecticut 06856-5116  
United States of America

2 April 2009

Dear Mr Goldschmid and Mr Hoogervorst,

**Re: Financial Crisis Advisory Group Invitation to Comment – 10 March 2009**

Deloitte Touche Tohmatsu is pleased to respond to the Financial Crisis Advisory Group's Invitation to Comment of 10 March 2009 (the "Invitation to Comment").

We support strongly the work of the FCAG and welcome the opportunity to comment. We believe that the FCAG has identified appropriately the financial reporting issues that were brought to the fore by the current financial crisis. We believe that these issues are the significant accounting issues that require urgent and immediate attention of the boards.

We also support the efforts of financial reporting standard setters to improve the quality and transparency of financial reporting standards and the work of prudential regulators to improve their requirements to promote solvency and avoid pro-cyclicality. Their respective efforts have the aim of restoring confidence in the financial markets and are welcome. While often the objectives of financial reporting standard setters and prudential regulators will not be in conflict, there will be situations, as demonstrated by the current economic crisis, when the objectives do conflict. In resolving any conflicts, the primary purpose of general purpose financial statements to provide financial information about a reporting entity that is useful to current and potential capital providers should not be compromised. Prudential regulators, have the ability to attain necessary information outside of the financial statements and to make changes or adjustments to the financial information as they deem necessary and appropriate without having to make changes to the information needed by investors. Further to this point, we elaborate in our response to Question 2 that the information necessary for prudential regulators could be required as part of supplemental disclosures in ways that would not detract from the information capital providers require.

Our detailed responses to the invitation to comment questions are included in Appendix A.



If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907, Veronica Poole in London at +44 (0) 207 007 0884, or Bob Uhl in Wilton, Connecticut at (203) 761-3152.

Yours sincerely

A handwritten signature in black ink, appearing to read "Ken Wild", written over a horizontal line.

**Ken Wild**  
**Global IFRS Leader**

## **Appendix A: Invitation to Comment**

### **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.*

General purpose financial reporting is intended to provide financial information about a reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. In our view, these investor-focused financial reports have provided timely and relevant information to the financial markets and enabled the market to identify issues of concern appropriately.

In particular, information regarding fair value provided more decision-useful information to investors about the underlying financial circumstances than the possible alternatives. The US Securities and Exchange Commission's study on Mark-to-Market accounting issued to the Congress in December 2008 (the "MtM report") analysed the views of investors and other users of financial statements on the basis of comment letters, roundtable discussions, analysts' reports, prior published staff research on investors' views on mark-to-market accounting, and academic studies. On the basis of this information, the report concluded that there is general support among investors that fair value provides "reliable and comparable" information and increases the quality of information available to investors, including the transparency of the value of assets and liabilities in the current economic climate. Failure to provide fair value information would have kept investors and policy decision makers in the dark about credit and liquidity challenges. Recent history, including the US Savings and Loan crisis of the 1980s and the Japanese financial crisis of the 1990s, demonstrates that less than transparent financial reporting exacerbates the problem, prolongs uncertainty in the market, and reduces investor confidence in the reported numbers.

In the absence of deep and liquid ('active') markets, additional guidance is necessary to explain how the existing financial reporting standards should be applied. However, the fundamental premise on which those standards are based was, and remains, sound. Under IFRS, the IASB's Expert Advisory Panel report issued in October 2008 has been effective at raising the level of understanding for practitioners, auditors and users on fair value measurement in inactive markets. The report, however, is non-mandatory educational guidance and we welcome the IASB's efforts in considering how the report, and which aspects of it, should be incorporated into the financial instruments and the forthcoming fair value measurement standards. Under US GAAP, the FASB has been responsive by adding several projects to its agenda to provide additional guidance around fair value measurements, such as providing more implementation guidance on measuring the fair value of liabilities.

However, we believe the FASB's most recent proposed FSP, FSP FAS 157-e, is a fundamental change to providing fair value information and will not provide better information to users. The proposed FSP attempts to address how to determine fair value when markets are inactive. However, the proposed FSP creates a measure that is not consistent with the definition of fair value. The definition of fair value in FASB Statement 157 indicates that it is a price that a willing buyer would pay in the current market. The value obtained by applying the guidance in the proposed FSP is not one that a willing buyer would accept in the current market but is a hypothetical value for an active market. As explained in our comment letter of 31 March 2009 to the FASB on the proposed FSP, we believe that if issued as final, the FSP will have several negative unintended consequences and will significantly reduce the transparency that investors and other users of financial statements seek.

Despite its imperfections, fair value information provides the levels of transparency that our markets need to function effectively. Any fundamental change to providing fair value information runs the risk of reducing confidence among investors and other market participants, which in turn would restrict the flow of capital.

## 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.*

Regulators' objectives are rightly concerned with solvency and pro-cyclicality. These objectives do not always coincide with the objectives of general purpose financial reporting as identified by financial reporting standard setters. Clearly, regulators need to form their own judgement on capital requirements and financial statements are an input to this process. We support the moves to improve regulation so as to respond to recent events. If prudential regulators were to conclude that 'through-the-cycle' or 'dynamic' provisioning is the right way forward, we are of the view that such an approach should not be used as the basis for establishing impairments in the general purpose financial statements. Under 'through-the-cycle' type of approach, the amount of impairment is a function of not only the incurred or expected losses on the loans a bank holds but also of where in an economic cycle the economic environment in which the loan is originated happens to be. This involves reliance on statistics. Statistics of the past are not necessarily indicative of future events, and any provisions set up on that basis might prove inadequate at times of economic shocks that do not follow historical patterns.

Furthermore, there is often a mismatch between loan lives and the duration of an economic cycle. The average duration of an economic cycle is 10-15 years, while for loans it is generally significantly shorter, so there would be little relationship between the loans held and the amounts provided for impairment. If loss rates do not rise as economic conditions deteriorate there could be a delay in corrective management action, so actually exacerbating future economic shocks.

'Through-the-cycle' provisioning methodologies would reduce comparability between entities and countries as it would be difficult to apply and enforce the requirements in a sufficiently similar fashion. Directors and auditors may not be in a position to resolve between them questions on where the entity is in the economic cycle and regulatory involvement may be necessary. This would raise the question of whether it is appropriate for prudential regulators to take over the responsibility of establishing accounting estimates as directors would no longer be accountable for their reported results.

While, for the reasons outlined above, we believe that 'through-the-cycle' approach should not be used as a basis for calculating impairments, we believe that disclosure of information about any buffer over and above the loan loss experience that prudential regulator requires may be valuable to investors. This number could be disclosed as an appropriation of equity outside of comprehensive income or as a footnote in the accounts. We would encourage the IASB to seek input from investors to establish what regulatory capital information in addition to that already required in IAS 1 would benefit them.

We acknowledge that there are various issues related to the application of the incurred loss model, some of which were highlighted by the economic crisis and we welcome the work that the FASB and the IASB are undertaking in this area which includes consideration of the merits of the expected loss model as compared to the currently used incurred loss. We believe that a comprehensive project on impairment designed to meet the needs of debt and equity providers is the right way to proceed and should lead to alignment of impairment measurement for both standard setters.

## 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?*

We note that the issue of accounting for and financial reporting of off-balance sheet items was highlighted by the Financial Stability Forum in their report issued in April 2008. That report noted that the “build-up and subsequent revelation of significant off-balance sheet exposures has highlighted the need for clarity about the treatment of off-balance sheet entities and about the risks they pose to financial institutions” and recommended that the IASB “should improve the accounting and disclosure standards for off-balance sheet vehicles on an accelerated basis and work with other standard setters toward international convergence.”

In our view, the IFRS consolidation model, based on the concept of control, as set out in IAS 27 *Consolidated and Separate Financial Statements* together with SIC-12 *Consolidation—Special Purpose Entities*, to a large extent operated well. However, it is appropriate to undertake a thorough review of the situations where it is judged that the current IFRS control model failed to deliver the right outcome.

During the current financial crisis some financial institutions voluntarily repurchased financial interests issued by, or provided liquidity to, special purpose entities (in which they generally acted as sponsor/ originator) that they did not consolidate. The purpose of the original transactions was to provide the financial institutions with funding that otherwise could not be obtained due to liquidity constraints in the open market. The underlying thinking for the repurchase transaction or extension of liquidity was to protect the credibility or reputation of the originating/ sponsoring banks. Under current IFRS guidance, this reputational risk is not considered a basis for consolidation as it is not contractual, nor is it considered in the overall consideration of whether control exists. This ‘non-consolidation’ attracted significant criticism, with some commentators advocating that reputational risk should be made part of the control assessment or otherwise form a separate basis for consolidation when the current consolidation guidance is revised.

We would observe that consolidating entities based on a principle other than control has the potential to provide extraneous information that will confuse users and not reflect accurately the true assets and liabilities of the entity. In situations in which an entity is exposed to risks through another entity it does not control, disclosure is a better way to inform users of the entity’s exposures.

The IASB issued ED 10 *Consolidated Financial Statements* in December 2008, which included proposals with respect to ‘structured entities’. The IASB considered whether reputational risk should form a basis of consolidation of such entities and concluded that it should not as such risk is akin to a general business risk. We support this conclusion and agree that disclosure enabling an assessment of the reputational risk is necessary to understanding of the business risks an entity may be exposed to through its involvement with structured entities.

We agree with the recommendation of the Financial Stability Forum that better disclosure of off balance sheet vehicles is needed, but we believe that the focus has to be on targeted and effective disclosures rather than on a volume of data.

In responding to the invitation to comment on ED 10 *Consolidated Financial Statements*, we wrote:

We recognise the importance and fully support the objectives of issuing a single Standard for consolidation and improving the disclosure requirements about consolidated and unconsolidated entities. Furthermore, we believe that applying a single definition of control to all entities is the right basis for the consolidation model.

However, the guidance within the ED is ambiguous and inconsistent in a number of fundamental areas, not least in its failure to distinguish between ‘power’ and ‘ability’. Without a clear definition of control,

the resulting Standard will be difficult to interpret and apply on a consistent basis. As a consequence, the financial statements of groups will be less, not more, comparable and understandable. We do not believe that the ED in its current form is an improvement on existing IFRSs.

However, we recognise also that it is crucial that the Board responds on a timely basis to the global financial crisis and the recommendations of the Financial Stability Forum. We therefore believe that the improved disclosure requirements should be issued as swiftly as possible. However, further work is required to address adequately concerns about the consolidation model itself, including appropriate field testing.

In the US, ARB 51 and Interpretation 46(R) have a different focus and attracted much criticism. The FASB has added a project to address these issues and is expected to issue final standards amending Statement 140 and FASB Interpretation 46(R) in the second half of 2009.

While we agree with the decision to eliminate the concept of ‘qualifying special purpose entities’ we have concerns about many of the proposed changes to the current Interpretation 46(R) model. Rather than retaining the current two model approach, we are supportive of the development of a single consolidation model applicable to all entities that considers both governance and risks and rewards in determining whether an entity has control over another entity. We believe such a model is superior to the current two model approach. Therefore, rather than issuing the proposed revised Interpretation as a final standard, we believe the FASB should work with the IASB to develop a common consolidation model that can be applied by all entities reporting under either US GAAP or IFRS.

Furthermore, because consolidation and derecognition are inextricably linked, we also strongly encourage the FASB and IASB to develop concurrently a common derecognition principle. The requirements on derecognition of financial assets are critical in the accounting for securitisations. The main criticism is that a number of practical issues identified and submitted to both Boards and IFRIC remain unresolved because of the anticipated issue of an exposure draft on derecognition. The consolidation and derecognition principles should be conceptually consistent, based on the concept of control, and consistent with the definitions of an asset and a liability in the joint conceptual framework. We believe that such consistent principles are fundamental to representing assets and liabilities of a reporting entity more faithfully. Until a joint standard becomes effective, we support requiring increased disclosures in the interim.

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

We agree that current guidance under IFRS and US GAAP is complex and requires significant improvements to reduce the inherent complexity. We welcome the IASB’s and FASB’s efforts to improve financial reporting for financial instruments.

In our comment letter of 19 September 2008 responding to the Discussion Paper – *Reducing Complexity in Reporting Financial Instruments*, we wrote:

We believe that complexity cannot be eliminated and what may appear to be a reduction in complexity on closer analysis may merely transfer complexity from one constituent to another. For example, removing a mixed measurement model through comprehensive use of fair value may reduce complexity for users as it reduces the number of options for classification and thereby improves comparability, but will increase the complexity for preparers and their auditors, particularly when valuing financial instruments that are

not actively traded due to the associated subjectivity. Similarly, removing cash flow hedge accounting may appear to reduce complexity for preparers as all derivatives will be fair valued through profit or loss and entities will avoid the burden of designating and monitoring hedge effectiveness, however it would increase complexity as financial results will be less understood as gains/losses on derivatives will be recognised in a different period to the forecasted transaction that is being hedged. In addition, reducing complexity in one area of the financial statements, e.g. decreasing the number of measurement attributes, will increase complexity in another, e.g. fair value measurement and disclosures for instruments that are derived using valuation models.

We do not agree with the implicit assumption of the DP that full fair value accounting would be the ultimate improvement to financial instruments accounting. In our view, such a conclusion was premature. We believe that amending existing Standards, possibly over a longer period, would be a feasible way to improve financial instruments accounting significantly for all constituents without undue costs or efforts. In the letter we set out an approach that, whilst still incorporating a mixed measurement attribute model would, in our view, represent a significant improvement over the current guidance in IFRS. Our approach also included a proposal for improving hedge accounting that we consider superior to the existing model in IAS 39 *Financial Instruments: Recognition and Measurement*.

We attach a copy of our comment letter which includes our proposal to introduce a less complex mixed-measurement model than is currently required by existing Standards.

In this regard, we welcome the announcement by the IASB and the FASB, following from their joint meeting in March, to replace their respective financial instruments standards with a common standard in a matter of months, not years.

## **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?*

The Boards need the ability to be flexible, while in normal circumstances maintaining their wide consultation with constituents, agenda advisory groups (e.g., SAC and FASAC), and others. While reasonable flexibility in setting their agendas is important, in extreme circumstances, clear and open communication to constituents on the rationale and criteria to elevate an agenda item as an "emergency issue" is needed in order to ensure high quality process in setting standards that are broadly accepted. We note that FASB and FASAC undertake an annual survey of the FASB's constituents on the FASB's technical agenda. This survey has a high degree of credibility both at the FASB and with constituents. In particular, the survey assists the FASB in identifying trends in financial reporting, which, in turn, assists them in making resource allocations as appropriate. In the past, the IASB has not been particularly successful in developing communications with constituents with respect to how it determines its technical agenda and assigns relative priorities. We encourage the IASB, SAC and the Trustees to give the constituents an opportunity to comment on the IASB's agenda and relative priorities.

In extraordinary times, the FASB due process provides for shortening the "normal" comment period, and this has been enacted for some of the recent projects associated with the credit crisis. While recognising the urgency of those projects, we commend the balance shown by the FASB to continue to ensure some period for comment rather than overriding its due process. We note that the IASB's Due Process Handbook (paragraphs 97-98) also provides for very short comment periods without having to obtain an explicit permission of the IASC Foundation Trustees. However, we think that the Due Process Handbook should be amended to acknowledge that comment periods shorter than 30 days could be used in particularly extreme circumstances. While we acknowledge the extraordinary circumstances of October 2008, if the IASB is to maintain its reputation as the global independent private-sector financial reporting standard setter, the IASB should not bypass its due process in response to pressure from any region or jurisdiction.



## 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?*

As noted in our response to Question 2, we would encourage the IASB to seek input from investors to determine what regulatory capital information, if any, would benefit them. If investors believe regulatory capital information would be beneficial, we believe the IASB will need to have dialogue with prudential regulators and the auditing profession to determine how to best serve the needs of investors without jeopardising the auditability of any such information.

## Question 7

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

We welcome this initiative and support most strongly the work of the FCAG so far.

In addition to the comments already expressed, we agree with the recommendation in the SEC's Advisory Committee's Report on the Improvements to Financial Reporting that a creation of a Financial Reporting Forum (FRF), where key public and private parties would be represented in the accounting standard setting process. As proposed, the FRF would have regularly scheduled meetings and, when necessary, special meetings on short notice. These meetings would include the discussion of issues with key representatives from the SEC, FASB, and PCAOB. Although its decisions would not be binding, the FRF is expected to address issues related not only to the FASB, but to financial reporting and other system-wide priorities.

Given the global nature of their activities, it is necessary for the IASC Foundation and the IASB to engage constituents on multiple levels. We welcome the appointment of the Monitoring Board as the means for the Trustees to engage public authorities. We also see clear benefits of a group similar to the FRF that would meet regularly to advise the IASB on its agenda and effectiveness of standards and that helps it coordinate with the International Auditing and Assurance Standards Board. We encourage the IASC Foundation Trustees to consider an initiative similar to the FRF in the US, drawing on members of the reconstituted Standards Advisory Council; the IASB's existing users' and preparers' forums; and other key stakeholders, including the IAASB ; members of IOSCO; and prudential regulators.

One further area highlighted by the crisis is the need for guidance under IFRS as to how financial statements should be prepared once it is concluded an entity is no longer a going concern. The guidance should address not only the relevant measurement, presentation and disclosure issues, but also the question of whether the preparer of the financial statements could still claim compliance with IFRS.

Finally, we believe that any revisions for regulatory purposes that deviate from the objective of providing investors with decision-useful information should remain outside of the financial statements. As noted in Question 1, general purpose financial reporting is intended to provide financial information that is useful to investors, lenders, and other creditors in making decisions in their capacity as capital providers. It is our view that regulators' objectives may not always coincide with the objectives of general purpose financial reporting.