Federation of European Accountants
Fédération des Experts comptables Européens

1 April 2009

Mr. Stig Enevoldsen
Chairman Technical Expert Group
EFRAG
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E-mail: info@efrag.org

Ref. FRP/SS/SL

Dear Mr. Enevoldsen,

Re. EFRAG Draft Comment Letter on the Financial Crisis Advisory Group Request for Input

(1) FEE (the Federation of European Accountants) is pleased to provide you with its comments on the draft EFRAG comment letter on the Financial Advisory Group request for Input. We have also provided input directly to the Financial Crisis Advisory Group and enclose a copy of our letter.

(2) Although we appreciate the level of details and comprehensiveness of the letter, we are of the opinion that often no clear position is expressed and no specific answers are provided. Instead, the letter discusses a range of possible positions and opinions. We believe that it would be better if the final letter were more directionally clear.

<u>Cover Letter</u>

(3) The position on the relationship between general purpose financial statements and prudential reporting is not clearly expressed. FEE is of the opinion that regulatory reporting and general purpose financial reporting have different objectives. Therefore, any (further) differences between general purpose financial reporting and prudential/regulatory reporting should be motivated. There should be proper reasons for having and maintaining such differences. Financial stability is primarily the responsibility of the regulators. The financial reporting role in financial stability is to provide and, in the current circumstances, restore market confidence by providing transparency as well as a fair view of financial performance and economic strength of entities in individual reporting periods. This role is so important that it should not be biased by attempts to counter potential pro-cyclical effects, which do not reflect the inherent underlying economical cyclicality faced by the reporting entity. Primacy should not be given to the needs of governments and regulators since they typically have the power to obtain additional information directly from the company's management.

(4) It may be helpful if the letter referred to the level playing field between IFRS and US GAAP. This is especially relevant now where FASB is consulting on its guidance on fair value measurement (FSP 157e) and impairment of available for sales financial instruments (FSP 115). The letter could also refer to the related risk of driving financial reporting towards the lowest common denominator. FEE supports the need to seek convergence, provided that this leads to the highest quality accounting solutions.

Appendix EFRAG's Response to the Questions Raised in the FCAG's Request for Input

Question 1

(5) In order to give a balanced picture, it would be helpful to refer in paragraph 3 to the fact that financial reporting, in particular reporting based on IFRS, has revealed the economic reality of market participants' positions at an earlier stage than otherwise would have been the case. Financial reporting has shown that financial institutions have been highly geared.

(6) FEE is of the opinion that transparency of the financial performance is the key objective of financial reporting and therefore regulatory adjustments should not automatically have financial reporting implications.

(7) FEE is of the opinion that the primary focus of financial statements should remain on the needs of capital market participants. Financial stability is primarily the responsibility of the regulators. The financial reporting role in financial stability is to provide and in the current circumstances restore market confidence by providing transparency and a true and fair view on financial performance and position in individual reporting periods. We believe that the picture provided in paragraph 5(b) stating that "capital market participants are very interested in prudential capital requirements" should be more nuanced.

(8) Paragraph 5(c) is unclear as there is no description of the advantages referred to. We agree that there need to be good grounds for introducing (further) differences between prudential returns and general purpose financial statements.

(9) In relation to paragraph 7 of the EFRAG draft comment letter, we wish to observe that in our view the effects of the current market volatility are captured, but not caused by fair value accounting. FEE believes strongly that financial reporting based on IFRS, and notably fair value accounting for financial instruments, has revealed the economic reality of market participants' positions at an earlier stage than otherwise would have been the case under a more cost basis driven model. In our view, the requirement to account for certain financial instruments at fair value has not caused the financial crisis nor has it been a significant contributing factor. Nevertheless, practice has shown that fair value accounting is more difficult to apply in illiquid markets and preparers and auditors have had to use significant judgments to arrive at consistent valuations in difficult market circumstances. Preparers would benefit from additional guidance on fair value measurements when observable market prices are not available. In particular, additional guidance on the effect of illiquidity and risk premia could result in greater comparability of information across industry sectors and geographic boundaries.

(10) We believe that EFRAG should take strong position in paragraph 8(b) against the use of some sort of average market value since EFRAG should not be seen as supporting smoothing. We also suggest to delete the last sentence of paragraph 8(b) of the EFRAG draft comment letter.

(11) In relation to paragraph 9(b) of the EFRAG draft comment letter, we are of the opinion that value in use is not a good example for financial instruments measurement. One possibility would be to refer to the FSP 157(e) debate.

(12) In relation to paragraphs 11 to 14, we refer to the Policy Statement on Dynamic Provisioning for Financial Instruments that FEE has recently issued. We suggest that the draft comment letter should also set out that dynamic provisioning as such has procyclical implications. In fact, what is needed is a "stress loss" provisioning model in regulatory reporting. The paragraphs should also refer to the difficulty to determine when one is at the bottom of the downturn. In paragraph 13, EFRAG should take a position and we suggest this should be to express support for the third possibility as set out in (c) in line with the FEE Policy Statement.

(13) In relation to paragraph 16 of the EFRAG draft comment letter, we wish to observe that 2007 was the first year that IFRS 7 was required to be applied: it is expected that risk disclosures will further improve over time when there is more experience with applying the standard. The Financial Stability Forum disclosure requirements have also enhanced the risk disclosures.

(14) We suggest to delete paragraph 18 of the EFRAG draft comment letter since it does not help the reasoning on measurement and is largely superfluous. Moreover, paragraph 21 is a duplication of the earlier text and could in our view also be omitted. Avoiding repetition will make the letter more readable.

Question 2

(15) We suggest that EFRAG takes a clearer position and expresses support for approach (3). In addition, we suggest deleting the last sentence of paragraph 25.

Question 3

(16) We have no specific comments and refer to our letter to the Financial Crisis Advisory Group.

Question 4

(17) We agree with supporting a mixed attributes model.

Question 5

(18) The EFRAG reasoning is broadly in line with the FEE reasoning on fast track procedures.

Question 6

(19) We support EFRAG's observations.

For further information on this letter, please contact Ms. Saskia Slomp from the FEE Secretariat.

Yours sincerely,

Hans van Damme
President

<u>Encl.</u>