

REPORT OF THE FINANCIAL CRISIS ADVISORY GROUP

JULY 28, 2009

July 28, 2009

**To the Members of
the International Accounting Standards Board
and the US Financial Accounting Standards Board:**

On behalf of the members of the Financial Crisis Advisory Group (FCAG), we are pleased to present our report to the Boards about the standard-setting implications of the global financial crisis.

We believe that confidence in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth. We hope that our conclusions and recommendations will be helpful to the Boards as they work together to simplify and improve accounting standards on financial instruments and other key areas highlighted by the crisis.

The FCAG will be meeting in December to review the progress that has been made. In the meantime, we are available to assist the Boards in their efforts.

Sincerely,



Harvey J. Goldschmid
Co-chair



Hans Hoogervorst
Co-chair

cc: Gerrit Zalm, Chairman of the Board of Trustees,
International Accounting Standards Committee Foundation

John J. Brennan, Chairman of the Board of Trustees,
Financial Accounting Foundation

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I. Introduction

The global financial crisis has led many economic and financial market participants to reexamine their governance, practices, and standards. The Financial Crisis Advisory Group (the “FCAG”) was formed to advise the International Accounting Standards Board (the “IASB”) and the US Financial Accounting Standards Board (the “FASB”) about the standard-setting implications of the financial crisis and potential changes in the global regulatory environment. Our members are senior leaders with broad international experience in the financial markets, and we have been joined by official observers representing key global banking, insurance and securities regulators (see Appendix I).

In the course of our work, we have discussed a wide range of issues, including but not limited to those listed in our charter (see Appendix II). We held six meetings in either London or New York, substantially all of which were conducted in public sessions, except for time spent on drafting this report. We solicited written input from interested parties and received 56 responses, including many from prominent international organizations (see Appendix III). The full text of the responses, as well as a summary, have been made public.¹ We also considered significant studies and reports relevant to our work.

Our focus has been primarily on issues relating to financial institutions because of their central place in the crisis. However, we believe that many of our conclusions and recommendations apply generally to all business entities.

In our discussions, we recognized the critical role that general purpose financial reporting (“financial reporting”) plays in the financial system and we identified four principles that financial reporting must meet if it is to fulfill this role well. We believe that the financial crisis has underscored the importance of these principles. The principles are as follows:

1. *Effective Financial Reporting*

Financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of businesses. Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of those standards.

Financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions and to regulators and other users. The confidence of all these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth.

Where regulatory standards differ from accounting standards in ways that could have significant effects on financial reporting, the effects of those differences should be disclosed in a manner that does not compromise the transparency and integrity of financial reporting.

¹ These are available on the FCAG pages of the IASB and FASB websites at www.iasb.org and www.fasb.org, respectively.

2. *Limitations of Financial Reporting*

Although effective financial reporting provides indispensable rigor and transparency to the market, investors, analysts, regulators and others cannot rely exclusively on the information it provides. All users should recognize the limitations of financial reporting: it provides only a snapshot in time of economic performance and cannot provide perfect insight into the effects of macro-economic developments. Financial reporting is also dependent on the generation of reliable data by well-functioning markets that have proper infrastructure, and the use by financial institutions and other business entities of proper processes for price verification and other aspects of the valuation of assets and liabilities.

3. *Convergence of Accounting Standards*

Because of the global nature of the financial markets, it is critically important to achieve a single set of high quality, globally converged financial reporting standards that provide consistent, unbiased, transparent and relevant information, regardless of the geographical location of the reporting entity.

4. *Standard Setter Independence and Accountability*

To develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest.

We reviewed the governance, practices, and standards of the Boards that are most relevant to the financial crisis in light of these principles and have formulated our recommendations accordingly. We strongly believe that to develop high quality, unbiased accounting standards that are widely accepted, the Boards must follow their due process procedures, including wide consultation with interested parties, and our recommendations on possible new standards are not intended to preempt the outcome of that due process. Because we anticipate that our report will be of interest to the Boards' constituents, as well as to policymakers, we have included certain recommendations that relate to matters not wholly within the purview of the Boards.

II. Principle 1: Effective Financial Reporting

Financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of businesses. Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of those standards.

Financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions and to regulators and other users. The confidence of all these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth.

Where regulatory standards differ from accounting standards in ways that could have significant effects on financial reporting, the effects of those differences should be disclosed in a manner that does not compromise the transparency and integrity of financial reporting.

While the post-mortems are still being written, it seems clear that accounting standards were not a root cause of the financial crisis.² At the same time, it is clear that the crisis has exposed weaknesses in accounting standards and their application. These weaknesses reduced the credibility of financial reporting, which in part contributed to the general loss of confidence in the financial system. The weaknesses primarily involved (1) the difficulty of applying fair value (“mark-to-market”) accounting in illiquid markets; (2) the delayed recognition of losses associated with loans, structured credit products, and other financial instruments by banks, insurance companies and other financial institutions; (3) issues surrounding the broad range of off-balance sheet financing structures, especially in the US; and (4) the extraordinary complexity of accounting standards for financial instruments, including multiple approaches to recognizing asset impairment. Some of these weaknesses also highlighted areas in which International Financial Reporting Standards (“IFRS”) and US generally accepted accounting principles (“US GAAP”) diverged.

In the early part of the crisis, the principal criticism of financial reporting focused on fair value accounting. This criticism contended that fair value accounting contributed to the pro-cyclicality of the financial system. Prior to the crisis, it is argued, fair value accounting led to significant overstatement of profits; however, during the crisis, it was supposed to have led to a severe overstatement of losses and the consequent “destruction of capital.” Thus, the argument went, a vicious cycle ensued: falling asset prices led to accounting write-downs; the write-downs led to forced asset sales by institutions needing to meet capital adequacy requirements; and the forced sales exacerbated the fall in asset prices.³ In the US, moreover, critics singled out the other-than-temporary impairment standards for available-for-sale and held-to-maturity securities as being particularly “destructive” because institutions were forced to take charges against earnings as a consequence of what they believed to be temporary “market irrationality.”⁴

² See, for example, the *Policy Statement of the President's Working Group on Financial Markets* (March 2008), the report of the Financial Stability Forum entitled *Enhancing Market and Institutional Resilience* (April 2008), SEC Release No 33-8975, *Report and Recommendations Pursuant to Section 133 of the Emergency Economic Stabilization Act of 2008: Study on Mark-to-Market Accounting* (December 30, 2008), and the report of the Committee on Capital Markets Regulation entitled *The Global Financial Crisis: A Plan for Regulatory Reform* (May 2009). While these reports all contain recommendations for necessary improvements to accounting standards, they point to other factors as root causes of the financial crisis.

³ In many prudential regulatory regimes, capital adequacy standards are closely tied to accounting figures.

⁴ These standards have no direct counterpart under IFRS.

Proponents of fair value accounting do not deny that indeed mark-to-market accounting shows the fluctuations of the market, but they maintain that these cycles are a fact of life and that the use of fair value accounting does not exacerbate these cycles. Moreover, they argue that fair value accounting standards provided “early warning” signals by revealing the market’s discomfort with inflated asset values. In their view, this contributed to a more timely recognition of problems and mitigation of the crisis.

Whatever the final outcome of the debate over fair value accounting, it is unlikely that, on balance, accounting standards led to an understatement of the value of financial assets. While the crisis may have led to some understatement of the value of mark-to-market assets, it is important to recognize that, in most countries, a majority of bank assets are still valued at historic cost using the amortized cost basis.⁵ Those assets are not marked to market and are not adjusted for market liquidity. By now it seems clear that the overall value of these assets has not been understated – but overstated. The incurred loss model for loan loss provisioning and difficulties in applying the model – in particular, identifying appropriate trigger points for loss recognition – in many instances has delayed the recognition of losses on loan portfolios. (The results of the US stress tests seem to bear this out.) Moreover, the off-balance sheet standards, and the way they were applied, may have obscured losses associated with securitizations and other complex structured products. Thus, the overall effect of the current mixed attribute model by which assets of financial institutions have been measured, coupled with the obscurity of off-balance sheet exposures, has probably been to understate the losses that were embedded in the system.

Even if the overall effect of accounting standards may not have been pro-cyclical, we consider it imperative that the weaknesses in the current standards be addressed as a matter of urgency. Improvements in accounting standards cannot “cure” the financial crisis by resolving underlying economic and governance issues (for example, the massive overleveraging of the global economy, excessive risk taking, and the undercapitalization of the banking sector). However, as demonstrated by the positive market reaction to disclosure of the results of the US stress tests, improvements in standards that enhance transparency and reduce complexity can help restore the confidence of financial market participants and thereby serve as a catalyst for increased financial stability and sound economic growth. Conversely, any changes in financial reporting that reduce transparency and allow the impact of the crisis to be obscured would likely have the opposite effect, by further reducing the confidence of market participants and thereby prolonging the crisis or by laying the foundation for future problems.

We should note that the Boards were working together to address some aspects of these issues before the brunt of the financial crisis occurred. Most importantly, the Boards had been aware of the excessive complexity of financial instruments standards (IAS 39, *Financial Instruments: Recognition and Measurement*, and the corresponding FASB standards) and had issued a Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*, in March 2008. Currently, both IFRS and US GAAP employ elaborate mixed attribute models that are the product of many compromises over the years. Some financial instruments are measured at fair value with changes reflected in earnings; other instruments are measured at fair value with changes outside of earnings; and still others are measured on a historic basis (amortized cost). The category to which a particular instrument is assigned is dependent not only on its intrinsic characteristics but also on the reporting entity’s business model. There are multiple and inconsistent impairment approaches, complicated rules about transfers between categories (including so-called “tainting” rules) and hedge accounting rules that even experts struggle with. Critics contend that despite

⁵ See, for example, Table 1 of the report of the Joint FSF CGFS Working Group of the Financial Stability Forum (now Financial Stability Board) entitled *The Role of Valuation and Leverage in Procyclicality* (March 2009).

(and arguably because of) the complexity of these standards, financial reporting has not adequately depicted the risks associated with complex financial instruments (both on- and off-balance sheet).

While some complexity may be inevitable because of the nature of the instruments and the diversity of business models, in our view the overall level of complexity is unwarranted. We believe that, for conceptual and/or practical reasons, a simplified mixed attribute model, rather than a full fair value-through-earnings model, is preferable. We have urged the Boards to accelerate and in some cases broaden their efforts to simplify and improve their standards in the vital financial instruments area.

In addition, as part of the financial instruments project, we have suggested that the Boards reexamine the reporting of gains from declines in the fair value of a reporting entity's own indebtedness within profit or loss, as entities are now permitted to do when they have elected the fair value option under either IFRS or US GAAP.⁶ While there may be some conceptual justifications, reporting gains in profit or loss seems counterintuitive and may not provide relevant, decision-useful information when the gain results from a change in the credit risk of the borrower rather than from the general price of credit, especially when the borrower lacks the ability to buy its own debt and actually realize the gain.

The Boards have taken many actions to date to address the weaknesses in standards and difficulties in application that have been highlighted by the financial crisis (see Appendix IV). Generally speaking, we agree that these changes were necessary and appropriately responsive to or consistent with recommendations of the G-20, the Financial Stability Board and others seeking to enhance the stability of the international financial system.⁷ However, as discussed in Section V below, in some instances the Boards appear to have been subject to an undue level of business and political pressure and proper consultative procedures (which we refer to as "due process") were compromised, either in fact or – equally damaging – in appearance.

Perhaps the most significant change to date is the FASB's overhaul of its consolidation/derecognition (that is, off-balance sheet) standards, effective for calendar year 2010.⁸ The new standards are expected to greatly increase the percentage of securitizations included on the balance sheet. The FASB's action was important not only because it addressed a key weakness in US accounting standards but also because it brought US GAAP consolidation requirements much closer to IFRS, thus better positioning the two Boards to achieve full convergence in the consolidation/derecognition area. We strongly urge the implementation of the FASB's new standards without revision or delay.

⁶ The option is contained in IAS 39 and FAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, respectively.

⁷ See, for example, the communiqué issued on April 2, 2009 by the G-20 Leaders; the report of the Financial Stability Forum entitled *Enhancing Market and Institutional Resilience* (April 7, 2008); and the report of the Financial Stability Board entitled *Addressing Procyclicality in the Financial System* (April 2, 2009).

⁸ See FASB Statements Nos. 166 and 167, which are noted in Appendix IV. These were responsive to findings of the SEC Special Study entitled *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 on Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (June 15, 2005), which noted weaknesses in the standards.

The Boards have committed to take the following additional actions before year-end:

- As part of their comprehensive financial instruments project, which they have accelerated, to propose an improved, streamlined approach to the classification, recognition, and measurement of financial instruments. Specifically, the Boards are examining the number of financial instrument categories; the appropriate measurement attribute for each category (for example, fair value, amortized cost, other current value), whether and when impairments should be reflected within or outside of earnings, and accounting for hedging activities. The Boards are also considering approaches involving more forward-looking information with regard to the provisioning/accounting for loan losses, and under what circumstances and to what extent impairments of securities should be reversed to reflect subsequent recoveries.
- To make significant progress toward an improved and converged standard on consolidation and derecognition, building on the Exposure Drafts issued by the IASB in December 2008 and March 2009, respectively. As noted above, the FASB's recent changes in off-balance sheet standards give the two Boards a more converged starting point for this important project.
- To continue to make progress toward other improved, converged standards in accordance with the Memorandum of Understanding between the Boards (see Appendix V).

We strongly support these efforts of the Boards and believe that it is critically important that the Boards make substantial progress in these areas to help strengthen confidence in financial reporting as a key component of the financial system. As noted in Appendix IV, on July 14, 2009, as the first of three interlinked phases of replacing IAS 39, the IASB issued the Exposure Draft, *Financial Instruments: Classification and Measurement*, which contains proposals to improve the classification and measurement of financial instruments. The IASB expects to finalize that phase by year-end and issue proposals on its remaining two phases, on impairment methodology and hedge accounting, in October and December 2009, respectively. The FASB, which will be participating at public roundtables and joint meetings with the IASB, expects to issue a comprehensive proposal on these issues in December 2009 or January 2010. We are aware that the two Boards are currently contemplating somewhat different approaches. As discussed in Section IV below, while recognizing the paramount importance of maintaining and enhancing the high quality of standards and the difficult issues that remain to be resolved, we strongly urge the Boards to make every effort to achieve converged solutions as they proceed with this and their other joint projects.

Intersection of Prudential Regulation with Financial Reporting

Both accounting standard setters and prudential regulators serve the public interest.⁹ The mission of accounting standard setters is to promote the reporting of unbiased, transparent and relevant information about the economic performance and condition of businesses, including financial institutions, to investors and other financial market participants. The mission of prudential regulators is to promote the safety and soundness of financial institutions and to reduce the risk of institutional failure. Both financial market participants and prudential regulators rely on financial reporting as an important basis for decision-making and both have a significant interest in market stability and economic growth. However, in some circumstances, differences in the focus of accounting standard setters and prudential regulators as they pursue their missions may create conflicts (for example, transparency may not always be the best way to prevent a “run on the

⁹ In this report, we use the term “prudential regulators” to refer to banking and insurance regulators in contrast with securities and other market regulators. The latter have a direct role in enforcing the proper application of accounting standards by publicly traded entities and, as discussed in Section V below, a direct oversight role over the accounting standard setters themselves.

bank”). We believe these conflicts are manageable as long as the independence of both accounting standard setters and prudential regulators is respected.

Because the interests of financial market participants and prudential regulators often overlap, and because prudential regulators are important users of financial reporting, the financial system benefits from the regular discussions that have been instituted between accounting standard setters and prudential regulators about potential changes to accounting standards. For example, both accounting standard setters and prudential regulators now are inclined to agree that the incurred loss model and/or its application may delay recognition of losses. We also believe that accounting standard setters can provide valuable input to prudential regulators. For example, prudential regulators could benefit from the insight of accounting standard setters in making regulatory requirements (such as the Basel ratios) more transparent.

Prudential regulators may require institutions to adopt a wide range of measures, such as establishing regulatory provisions or reserves beyond the provisioning required by accounting standards.¹⁰ These additional regulatory requirements can affect an institution’s ability to undertake certain activities, including paying dividends and making stock buybacks. This is important information for analysts, investors and others who are making, or who are advising others making, resource allocation decisions and, thus, should be disclosed. However, disclosure must be made in a manner that does not compromise the transparency and integrity of financial reporting – specifically, in a manner that does not affect accounting net income/profit or loss or other key income statement-based metrics.

Recommendations

- 1.1. The Boards should give highest priority to their project to simplify and improve their standards on financial instruments, moving forward as a matter of urgency but with wide consultation.
- 1.2. Recognizing that in some areas, such as impairments, IFRS and US GAAP have different starting points, we nevertheless urge the two Boards to achieve converged solutions.
- 1.3. In the financial instruments project, the Boards should explore alternatives to the incurred loss model for loan loss provisioning that use more forward-looking information. These alternatives include an expected loss model and a fair value model.
- 1.4. If the Boards pursue an expected loss model, care must be taken to avoid fostering “earnings management,” which would decrease transparency.
- 1.5. In the financial instruments project, the Boards should reconsider the appropriateness of an entity’s recognition of gains or losses as a result of fair value changes in the entity’s own debt because of decreases or increases, respectively, in its creditworthiness.
- 1.6. Accounting standards, especially on financial instruments, consolidation/derecognition and risk disclosure, have special importance for prudential regulators.

¹⁰For example, *The Turner Review: A regulatory response to the global banking crisis* (UK Financial Services Authority; March 2009) advocates for contra-cyclical measures such as the creation of an undistributable Economic Cycle Reserve, whereby capital buffers would be augmented by setting aside profit in good years to anticipate losses likely to arise in the future (section 2.2(v), page 66).

Accordingly, it is important that the Boards continue their consultation with prudential regulators.

- 1.7. If an alternative to the incurred loss model is developed that uses more forward-looking information, it may well narrow the differences between the requirements of accounting standards and regulatory standards. To the extent differences remain, we urge the Boards to develop a method of transparently depicting any additional provisions or reserves that may be required by regulators without undermining the integrity of financial reporting by affecting income statement-based metrics.
- 1.8. While giving priority to the financial instruments project, we also strongly urge the Boards to make substantial progress on converged and improved standards on consolidation and derecognition (i.e., on off-balance sheet issues) and the other areas within their Memorandum of Understanding.
- 1.9. In the meantime, the FASB's new off-balance sheet standards should be implemented without revision or delay.
- 1.10. In the financial instruments and consolidation/derecognition projects, improvements should be made with an eye toward a better, more transparent depiction of the risks involved, especially with complex financial instruments.

III. Principle 2: Limitations of Financial Reporting

Although effective financial reporting provides indispensable rigor and transparency to the market, investors, analysts, regulators and others cannot rely exclusively on the information it provides. All users should recognize the limitations of financial reporting: it provides only a snapshot in time of economic performance and cannot provide perfect insight into the effects of macro-economic developments. Financial reporting is also dependent on the generation of reliable data by well-functioning markets that have proper infrastructure, and the use by financial institutions and other business entities of proper processes for price verification and other aspects of the valuation of assets and liabilities.

While effective financial reporting provides indispensable rigor and transparency to the market, the financial crisis has shown that it also has its limitations. Financial reporting only provides information about the performance of a business for a finite period and about the condition of a business at a point in time. Especially in turbulent times, financial information may be out of date when, or soon after, it is produced. Accordingly, in making resource allocation decisions, financial market participants should “look beyond the numbers” in the financial statements that they have before them by also taking into account other relevant qualitative and quantitative information, including performance trends, industry data (national and global), unrecognized intangible assets, risk factors, and information about strategy and the quality of management and governance. Similarly, while financial reporting provides information that is useful to regulators charged with assessing the financial stability of individual institutions (including such matters as capital adequacy), regulators can and should obtain any necessary additional information directly from the regulated institutions.

It is important to realize that no accounting standard could have accounted in a timely fashion for the enormous effects of the economic shock that has engulfed the world. This clearly belongs to the domain of economics, despite the fact that surprisingly few economists (or policymakers) foresaw what was coming.

It is also important to recognize that the quality of financial reporting can only be as good as the quality of the underlying data used by the preparer of the financial reports. Information about the fair value of assets and liabilities is, in many instances, dependent on well-functioning markets with infrastructure (including clearing mechanisms) that provide timely, reliable and relevant data. In many of the over-the-counter markets, especially those for structured products and derivatives, those mechanisms have been lacking. We strongly support efforts to reduce opacity by substantially strengthening the infrastructure of these over-the-counter markets.

The quality of the underlying data also depends on the use by financial institutions and other business entities of proper processes for verification of price and other valuation information.¹¹ The financial crisis has exposed severe weaknesses in the quality and the independence of these processes, along with other failures in risk management. Financial institutions (and investors) should not outsource their due diligence excessively (for example, to credit rating agencies) and should, wherever possible, separate price verification from sales, trading and other commercial functions.

¹¹ For a discussion of proper processes, see the report of the Group of 30 entitled *Enhancing Public Confidence in Financial Reporting* (2003); the report of the Senior Supervisors Group of the Financial Stability Forum entitled *Observations on Risk Management Practices during the Recent Market Turbulence* (March 2008); and the report of the Basel Committee on Banking Supervision entitled *Supervisory guidance for assessing banks' financial instrument fair value practices* (April 2009).

Recommendations

- 2.1. In their joint conceptual framework project, the Boards should clearly acknowledge the limitations of financial reporting.
- 2.2. Users of financial reporting should recognize its limitations and should never suspend their own judgment and due diligence.
- 2.3. We urge the appropriate authorities to ensure that all over-the-counter markets, especially those for structured products and derivatives, have robust infrastructure that fosters the transparency of market prices.
- 2.4. Business entities, especially financial institutions, should employ effective price verification processes and otherwise improve their valuation of assets and liabilities. For price verification to be most reliable, this function should, wherever possible, be completely independent of sales, trading and other commercial functions.

IV. Principle 3: Convergence of Accounting Standards

Because of the global nature of the financial markets, it is critically important to achieve a single set of high quality, globally converged financial reporting standards that provide consistent, unbiased, transparent and relevant information, regardless of the geographical location of the reporting entity.

By illuminating the interconnectedness of global financial institutions and markets and other systemic risks, the financial crisis has made the case for global convergence of accounting standards even more compelling than before. The traditional arguments in favor of convergence focus on cross-border capital formation and the promotion of efficient markets. However, particularly in times of stress, convergence also benefits the world's financial system by providing comparable, transparent and relevant information about financial institutions and other business entities that helps identify risk, promotes the efficient allocation of resources, and minimizes opportunities for regulatory arbitrage arising from the interplay between accounting and prudential regulatory standards. Moreover, as the events discussed in Section V below demonstrate, disparities in key standards open the door to intense pressure on the Boards for piecemeal, uncoordinated changes, with limited due process, at times when the need is actually greatest for joint, comprehensive, and broadly accepted action. In the current environment, these key standards relate to financial instruments; in the future, the standards at issue may differ but the pressure on standard setters may be just as intense.

Outside the United States, considerable progress toward convergence has already been achieved. Beginning notably in 2005 with member states of the European Union (the "EU"), approximately 100 countries now require or permit the use of IFRS by listed companies.¹² A number of these countries have changed their company and tax laws to reflect the use of IFRS. Many other countries, including Argentina, Brazil, Canada, Chile, India, Indonesia, Japan, Korea, Malaysia, Mexico and Singapore, have announced plans to adopt or converge with IFRS in the next several years. China has adopted accounting standards substantially in line with IFRS with the ultimate goal of full convergence.

Progress toward convergence has also been achieved between IFRS and US GAAP. In October 2002, the FASB and IASB entered into a memorandum of understanding known as the "Norwalk Agreement" in which they "pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained." Since that time the Boards have eliminated a number of differences in their standards and completed a major joint convergence project on business combinations. As discussed in Part II above, the Boards have been working on a number of other major convergence projects and, in response to the financial crisis, have significantly accelerated their joint financial instruments project and their consolidation/derecognition project.

In December 2007, the SEC eliminated the US GAAP reconciliation requirement for financial statements of non-US registrants that are prepared in full compliance with IFRS as issued by the IASB.¹³ In so doing, the SEC considered, among other things, the progress already made by the Boards toward convergence, the robustness of their continuing convergence process, the high

¹² See, for example, www.iasplus.com/country/useias.htm.

¹³ See SEC Release No. 33-8879, *Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U.S. GAAP* (December 21, 2007).

quality of IFRS and the results of the staff's review of IFRS financial statements filed by non-US issuers. The SEC is currently reviewing comment letters received relating to its November 2008 proposed *Roadmap for the Potential Use of Financial Statements Prepared in Accordance with International Financial Reporting Standards by U.S. Issuers*.¹⁴

In responding to the financial crisis, world leaders have urged the Boards to achieve convergence. At its April 2009 meeting, the G-20 concluded: "Standard-setters should make significant progress toward a single set of high quality global accounting standards." In June, the US Treasury made the same recommendation in its white paper, *Financial Regulatory Reform: A New Foundation*: "We recommend that the accounting standard setters make substantial progress by the end of 2009 toward development of a single set of high quality global accounting standards." We fully support these calls for convergence. Although maintaining and enhancing the high quality of accounting standards remain of paramount importance, and difficult issues remain to be resolved in the convergence process, we share the sense of urgency expressed by the G-20 and US Treasury.


Accordingly, we disagree strongly with any attempts on a national or regional basis, such as occurred in late 2008 and again in early 2009, to allow either "carve-ins" or "carve-outs" from full IFRS. Any retreat from IFRS as issued by the IASB to national or regional standards would have serious consequences for the global financial system. First, it would limit the ability of financial market participants, prudential regulators, and others to compare the economic performance and condition of financial institutions and industrial companies operating similar businesses but based in different jurisdictions. Second, it would reinstate impediments to cross-border capital-raising and, in particular, the flow of capital to developing countries. Third, it would subject non-US companies that are SEC registrants that do not follow IFRS as issued by the IASB to US GAAP reconciliation. Finally, and perhaps irretrievably, it would dissuade countries on the verge of adopting or converging with IFRS from doing so, and it would halt the momentum that has been created for convergence between IFRS and US GAAP and, potentially, for adoption of IFRS in the United States.

A final observation: As we noted in our Principle 1, effective financial reporting depends not only on high quality accounting standards, but also on the consistent and faithful application and rigorous independent audit and enforcement of those standards. Accordingly, even if accounting standards are converged, differences in financial reporting may arise as a result of differences in national or regional auditing standards or differences in enforcement. We believe that convergence in these areas is ultimately as important as convergence in the accounting standards themselves.

Recommendations

- 3.1. We strongly urge the Boards, consistent with the need for maintaining and enhancing high quality accounting standards, to use every effort to achieve converged solutions. This should be done in the projects that they have accelerated in response to the financial crisis (financial instruments and consolidation/ derecognition) and in the other projects covered by the Boards' Memorandum of Understanding.

¹⁴ See SEC Release No. 33-8982 (November 14, 2008).

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- 3.2. We urge national governments, financial market participants, and the global business community to support actively the development of a single set of high quality accounting standards.
 - 3.3. To sustain momentum, we encourage all national governments that have not already done so to set a timetable that is both practicable and firm for adopting or converging with IFRS.
 - 3.4. Even if accounting standards are converged, differences in financial reporting may arise from differences in national or regional auditing standards, or differences in enforcement. We urge the appropriate international organizations to take note and reach converged solutions and common interpretations that will harmonize with those of the accounting standard setters. We believe international accounting firms can play a particularly important role in this regard.

V. Principle 4: Standard Setter Independence and Accountability

To develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest.

We firmly believe that improvements in accounting standards can help promote global financial stability and sound economic growth by enhancing transparency, reducing complexity and restoring confidence that the extent of losses in the financial system has been recognized and disclosed. It is important that these improvements be made as a matter of urgency. In order for the improvements to have the desired effect, however, it is essential that the process is conducted, and is seen to be conducted, on the basis of both independence and accountability.

As the Boards proceed with their work, it is essential that policymakers respect the independence of the standard-setting process. Independence is critical to ensuring that standards will be unbiased and transparent; that they will be developed on the basis of technical excellence; and that they will not be made on a piecemeal basis that fails to take into account how the particular changes fit within the comprehensive system of financial reporting. Concern for the Boards' independence has traditionally focused on pressures that may be applied by special interests in the private commercial sector. Protecting the Boards from those special interests remains a critically important factor in their independence. The financial crisis has also, however, elicited a second set of intense pressures on the Boards from the public sphere. Because governments are more often now owners and guarantors of major industrial companies and financial institutions, it is particularly important that they support, and are seen to support, the independence of the standard setters.

At the same time that the Boards must enjoy freedom to act independently, they must also have a high degree of accountability to constituents. Accountability derives from two sources: appropriate due process procedures in setting accounting standards, and strong oversight conducted in the public interest. Failure in either of these areas calls the standards the Boards produce into question.

Due process procedures are intended to ensure that all voices in all geographic regions have an adequate opportunity to make their views known before changes in accounting standards are made. Wide consultation helps to ensure that the benefits to users of contemplated changes outweigh the costs of the changes to preparers. Wide consultation also promotes excellence, neutrality, the identification of unintended consequences and, ultimately, broad acceptance of the legitimacy of the standards that are adopted.

Trust in financial reporting relies heavily on the trust of market participants in the due process of the Boards. Perception is as important as reality. In October 2008, the IASC Foundation Trustees allowed the IASB to waive its due process procedures to effect an amendment to IAS 39 that excluded with limited retroactive effect certain financial instruments from asset classifications subject to fair value accounting. They did so under pressure that the EU would make its own changes to IFRS within a timeframe that did not allow the IASB time for due process.¹⁵ In April

¹⁵ The IASC Foundation Annual Report 2008 states (at page 5), "Had the Trustees and subsequently the IASB not acted, the likely outcome would have been a change, resulting in no guidance in the rules as to when such transfers are permitted, no guidance of required disclosure, and the possibility for greater inconsistency in application between IFRS and US GAAP."

2009, under pressure that the US Congress would change accounting standards by legislation, the FASB accelerated its normal due process before issuing guidance in several fair value areas. The FASB's actions rekindled pressure by the EU on the IASB (which takes a different approach to impairment) to make further changes allegedly to keep IFRS in lockstep with US GAAP. The FASB's actions also emboldened opponents of fair value accounting to press for further concessions such as ignoring market value entirely in determining fair value in inactive markets.

We fully understand that policymakers are under tremendous pressure to resolve the financial crisis and institute reforms, and that improvements in financial reporting are an important part of the reform agenda. However, during the last several months, we have become increasingly concerned about the excessive pressure placed on the two Boards to make rapid, piecemeal, uncoordinated and prescribed changes to standards, outside of their normal due process procedures. While it is appropriate for public authorities to voice their concerns and give input to standard setters, in doing so they should not seek to prescribe specific standard-setting outcomes.

We believe it is important to recognize that the truncating of due process, whether in fact or appearance, undermines public confidence in the integrity of the standard-setting process and therefore hinders broad acceptance of the standards themselves. Also, we are concerned that threats of potential carve-outs might eventually lead to a renewed fragmentation of the standard-setting process and reverse the momentum toward convergence. A return to the pre-IASB world of 100+ national standard setters would fly in the face of what we have so painfully learned from the financial crisis about the interconnectedness of financial markets and institutions – and would truly be a tragedy.

At the same time, we understand that at a time of acute crisis an expedited due process may be needed to make possible a timely response by the standard setters. For this reason it is important that the Boards define in advance the circumstances under which it is appropriate to act on the basis of expedited due process. Also, the contours of such expedited due process should be defined as clearly as possible and should ensure that the maximum degree of consultation practicable under the circumstances is obtained.

Accountability also derives from oversight of the Boards. For each of them, oversight exists at two levels. First, both Boards are monitored by independent boards of trustees. Second, they are subject to a level of regulatory oversight.

The FASB has accountability to the SEC, an independent US federal agency. The SEC has the authority and responsibility under the US federal securities laws to set accounting standards for public companies, but has historically looked to private sector standard-setting bodies to set and improve standards and has deferred to their judgment. In 2003, the SEC studied the FASB and its overseeing body, the Financial Accounting Foundation (the "FAF"), and determined that they met the criteria prescribed by Section 108 of the Sarbanes-Oxley Act of 2002 so that the FASB's standards may be recognized as "generally accepted" for purposes of the US federal securities laws.¹⁶ The SEC monitors the FASB and the FAF on an ongoing basis to ensure they continue to meet the statutory criteria and other SEC expectations.

The SEC sometimes refers issues relating to accounting standards to the FASB or the Emerging Issues Task Force (the interpretive body for US GAAP), which is overseen by the FASB. The SEC and its staff do not, however, prohibit FASB from addressing topics of its choosing and do not dictate the outcome of specific FASB projects, so long as the conclusions of the FASB are in

¹⁶ See SEC Release No. 33-8221, *Policy Statement: Reaffirming the Status of the FASB as a Designated Private Sector Standard-Setter* (April 23, 2003).

the interests of investor protection. Moreover, by virtue of the Sarbanes-Oxley Act, the FASB has a secure funding structure free from outside influence under which all SEC registrants are required to pay an accounting support fee. The SEC reviews the accounting support fee and, in connection with that review, the FAF's and FASB's annual budget.

The IASB is overseen by the IASC Foundation in a manner similar to the FAF's oversight of the FASB. However, the IASB does not have an underpinning under international law analogous to the FASB's underpinning. Accordingly, the IASC Foundation lacks the authority to require financing from those countries or issuers using IFRSs. In 2008, significant progress was made to increase the portion of the IASB's funding coming from levies and widely based national schemes, rather than voluntary contributions from individual companies. We believe it is essential, however, to ensure that the IASB has a permanent and fully independent funding structure.


We commend the IASC Foundation for bolstering the public accountability of the IASB by establishing a link to an independent Monitoring Board effective January 2009. The Monitoring Board presently consists of the relevant leaders of the Emerging Markets and Technical Committees of the International Organization of Securities Commission (IOSCO), the Japan Financial Services Agency, and the SEC.¹⁷ The European Commission participates in the Monitoring Board but has not signed on as a full member. The Basel Committee on Banking Supervision sits as a formal observer at meetings.

With the establishment of the Monitoring Board, the governance of the IASB is intended to parallel the governance of the FASB. While there may ultimately need to be a bolstering of the legal framework around the IASB and the IASC Foundation, establishment of the Monitoring Board represents a major improvement. We believe the Monitoring Board should be supported, its composition broadened geographically and its functioning given time to evolve.

Recommendations

- 4.1. The joint and comprehensive financial instruments project now underway should be the focus and chief priority of both Boards for the balance of 2009. In conducting this project, the Boards should not compromise their due process procedures. We have committed to review the progress made by the Boards before year-end. We believe it is of critical importance that neither business nor political pressures divert the accounting standard setters from the financial instruments project, which is so important to the global financial system.
- 4.2. To ensure the widespread acceptance of its work in urgent situations, the Boards should define in advance the circumstances under which it is appropriate to act on the basis of expedited due process. The Boards should also develop procedures to ensure that, in such circumstances, the maximum consultation practicable is obtained.
- 4.3. While, as part of the system of public accountability, policymakers can and should voice their concerns and provide input to standard setters, we urge them to refrain from seeking to prescribe specific standard-setting outcomes. Such restraint is important in maintaining public confidence in the independence of the standard setting process, and, thus, in financial reporting and the financial system as a whole.

¹⁷ A Co-Chair of the FCAG, Hans Hoogervorst, is the Chair of the Monitoring Board.

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- 4.4. To protect its independence from undue influence, the IASB must have a permanent funding structure under which sufficient funds are provided to it on an equitable and mandatory basis.
 - 4.5. To bolster the authority of the Monitoring Board, its composition should be broadened geographically to include securities regulators from a wider range of nations.

VI. Restatement of Principles and Recommendations

Principle 1: Effective Financial Reporting

Financial reporting plays an integral role in the financial system by striving to provide unbiased, transparent and relevant information about the economic performance and condition of businesses. Effective financial reporting depends on high quality accounting standards as well as the consistent and faithful application and rigorous independent audit and enforcement of those standards.

Financial reporting is of great importance to investors and other financial market participants in their resource allocation decisions and to regulators and other users. The confidence of all these users in the transparency and integrity of financial reporting is critically important to global financial stability and sound economic growth.

Where regulatory standards differ from accounting standards in ways that could have significant effects on financial reporting, the effects of those differences should be disclosed in a manner that does not compromise the transparency and integrity of financial reporting.

Recommendations

- 1.1. The Boards should give highest priority to their project to simplify and improve their standards on financial instruments, moving forward as a matter of urgency but with wide consultation.
- 1.2. Recognizing that in some areas, such as impairments, IFRS and US GAAP have different starting points, we nevertheless urge the two Boards to achieve converged solutions.
- 1.3. In the financial instruments project, the Boards should explore alternatives to the incurred loss model for loan loss provisioning that use more forward-looking information. These alternatives include an expected loss model and a fair value model.
- 1.4. If the Boards pursue an expected loss model, care must be taken to avoid fostering “earnings management,” which would decrease transparency.
- 1.5. In the financial instruments project, the Boards should reconsider the appropriateness of an entity’s recognition of gains or losses as a result of fair value changes in the entity’s own debt because of decreases or increases, respectively, in its creditworthiness.
- 1.6. Accounting standards, especially on financial instruments, consolidation/derecognition and risk disclosure, have special importance for prudential regulators. Accordingly, it is important that the Boards continue their consultation with prudential regulators.

- 1.7. If an alternative to the incurred loss model is developed that uses more forward-looking information, it may well narrow the differences between the requirements of accounting standards and of regulatory standards. To the extent differences remain, we urge the Boards to develop a method of transparently depicting any additional provisions or reserves that may be required by regulators without undermining the integrity of financial reporting by affecting income statement-based metrics.
- 1.8. While giving priority to the financial instruments project, we also strongly urge the Boards to make substantial progress on converged and improved standards on consolidation and derecognition (i.e., on off-balance sheet issues) and the other areas within their Memorandum of Understanding.
- 1.9. In the meantime, the FASB's new off-balance sheet standards should be implemented without revision or delay.
- 1.10. In the financial instruments and consolidation/derecognition projects, improvements should be made with an eye toward a better, more transparent depiction of the risks involved, especially with complex financial instruments.

Principle 2: Limitations of Financial Reporting

Although effective financial reporting provides indispensable rigor and transparency to the market, investors, analysts, regulators and others cannot rely exclusively on the information it provides. All users should recognize the limitations of financial reporting: it provides only a snapshot in time of economic performance, and cannot provide perfect insight into the effects of macro-economic developments. Financial reporting is also dependent on the generation of reliable data by well-functioning markets that have proper infrastructure, and the use by financial institutions and other business entities of proper processes for price verification and other aspects of the valuation of assets and liabilities.

Recommendations

- 2.1. In their joint conceptual framework project, the Boards should clearly acknowledge the limitations of financial reporting.
- 2.2. Users of financial reporting should recognize its limitations and should never suspend their own judgment and due diligence.
- 2.3. We urge the appropriate authorities to ensure that all over-the-counter markets, especially those for structured products and derivatives, have robust infrastructure that fosters the transparency of market prices.
- 2.4. Business entities, especially financial institutions, should employ effective price verification processes and otherwise improve their valuation of assets and liabilities. For price verification to be most reliable, these functions should, wherever possible, be completely independent of sales, trading and other commercial functions.

Principle 3: Convergence of Accounting Standards

Because of the global nature of the financial markets, it is critically important to achieve a single set of high quality, globally converged financial reporting standards that provide consistent, unbiased and transparent information, regardless of the geographical location of the reporting entity.

Recommendations

- 3.1. We strongly urge the Boards, consistent with the need for maintaining and enhancing high quality accounting standards, to use every effort to achieve converged solutions. This should be done in the projects that they have accelerated in response to the financial crisis (financial instruments and consolidation/derecognition) and in the other projects covered by the Boards' Memorandum of Understanding.
- 3.2. We urge national governments, financial market participants, and the global business community to support actively the development of a single set of high quality accounting standards.
- 3.3. To sustain momentum, we encourage all national governments that have not already done so to set a timetable that is both practicable and firm for adopting or converging with IFRS.
- 3.4. Even if accounting standards are converged, differences in financial reporting may arise from differences in national or regional auditing standards, or differences in enforcement. We urge the appropriate international organizations to take note and reach converged solutions and common interpretations that will harmonize with those of the accounting standard setters. We believe international accounting firms can play a particularly important role in this regard.

Principle 4: Standard Setter Independence and Accountability

To develop standards that are high quality and unbiased, accounting standard setters must enjoy a high degree of independence from undue commercial and political pressures, but they must also have a high degree of accountability through appropriate due process, including wide engagement with stakeholders and oversight conducted in the public interest.

Recommendations

- 4.1. The joint and comprehensive financial instruments project now underway should be the focus and chief priority of both Boards for the balance of 2009. In conducting this project, the Boards should not compromise their due process procedures. We have committed to review the progress made by the Boards before year-end. We believe it is of critical importance that neither business nor political pressures divert the

accounting standard setters from the financial instruments project, which is so important to the global financial system.

- 4.2. To ensure the widespread acceptance of its work in urgent situations, the Boards should define in advance the circumstances under which it is appropriate to act on the basis of expedited due process. The Boards should also develop procedures to ensure that, in such circumstances, the maximum consultation practicable is obtained.
- 4.3. While, as part of the system of public accountability, policymakers can and should voice their concerns and provide input to standard setters, we urge them to refrain from seeking to prescribe specific standard-setting outcomes. Such restraint is important in maintaining public confidence in the independence of the standard setting process, and, thus, in financial reporting and the financial system as a whole.
- 4.4. To protect its independence from undue influence, the IASB must have a permanent funding structure under which sufficient funds are provided to it on an equitable and mandatory basis.
- 4.5. To bolster the authority of the Monitoring Board, its composition should be broadened geographically to include securities regulators from a wider range of nations.

Appendix I: FCAG Members and Observers

Members*

Co-chairs

Harvey J. Goldschmid

*Former Commissioner, U.S. Securities and Exchange Commission
United States*

Hans Hoogervorst

*Chairman, AFM (the Netherlands Authority for the Financial Markets)
Europe*

Members

John Bogle

*Founder, Vanguard
United States*

Jerry Corrigan

*Goldman Sachs and Former President of the New York Federal Reserve Bank
United States*

Fermin del Valle

*Former President, International Federation of Accountants
Argentina*

Jane Diplock

*Chairman, International Organization of Securities Commissions Executive Committee
New Zealand*

Raudline Etienne

*Chief Investment Officer, New York State Common Retirement Fund
United States*

Stephen Haddrill

*Director General, Association of British Insurers
United Kingdom*

Toru Hashimoto

*Former Chairman, Deutsche Securities Limited
Japan*

Nobuo Inaba

*Former Executive Director, Bank of Japan
Japan*

* All members of the FCAG served in their personal capacities. The views expressed in this report do not necessarily reflect the views or policies of their respective institutions.

Appendix I, continued

Gene Ludwig

*Former Comptroller of the Currency
United States*

Yezdi Malegam

*Board Member, Reserve Bank of India
India*

Klaus-Peter Müller

*Chairman of the Supervisory Board, Commerzbank
Germany*

Don Nicolaisen

*Former Chief Accountant, U.S. Securities and Exchange Commission
United States*

Wiseman Nkuhlu

*Chairman of the Audit Committee, AngloGold Ashanti
Former Economic Advisor to the President of the Republic of South Africa
South Africa*

Tommaso Padoa-Schioppa

*Former Finance Minister
Italy*

Lucas Papademos

*Vice-President, European Central Bank
Europe*

Michel Prada

*Former Chairman, Autorité des Marchés Financiers
France*

Observers

- Basel Committee on Banking Supervision
- Committee of European Securities Regulators
- Financial Stability Board
- International Association of Insurance Supervisors
- Japan Financial Services Agency
- US Securities and Exchange Commission
- Nelson Carvalho, former Chairman, IASB Standards Advisory Committee (Brazil)
- Dennis Chookaszian, Chairman, US Financial Accounting Standards Advisory Council

Acknowledgments

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Jeffrey D. Mechanick, FASB

Charles Batchelor, KPMG

Ellen J. Odoner, Weil, Gotshal & Manges LLP

Appendix II: FCAG Charter

Overview of the Advisory Group

The International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) have a long-standing commitment to work together in an internationally coordinated manner on improving financial reporting standards. As part of that commitment, accounting issues emerging from the global crisis will be considered by both boards. The boards established an advisory group comprised of senior leaders with broad international experience with financial markets to assist in that important process.

The primary function of the advisory group is to advise the boards about standard-setting implications of (1) the global financial crisis and (2) potential changes to the global regulatory environment. The group will conclude its activities within approximately six months (or less) and will conduct advisory meetings during that time.

Areas Within the Advisory Group's Purview

The advisory group will consider how improvements in financial reporting could help enhance investor confidence in financial markets. The advisory group also will help identify significant accounting issues that require urgent and immediate attention of the boards, as well as issues for longer-term consideration.

In providing that advice, the advisory group will draw upon work already underway in a number of jurisdictions on accounting and the credit crisis, as well as information gathered from the public roundtables – one each in Asia, Europe, and North America – that the boards are hosting in November and December.

The advisory group is invited to discuss, among other issues, the following:

- Areas in which financial reporting helped identify issues of concern, or may have created unnecessary concerns, during the credit crisis.
- Areas where financial reporting standards could have provided more transparency to help either anticipate the crisis or respond to the crisis more quickly.
- Whether priorities for the IASB and the FASB should be reconsidered in light of the credit crisis.
- Potential areas that require future attention of the IASB and the FASB in order to avoid future market disruption.
- The implications of the credit crisis for the interaction between general purpose financial reporting requirements for capital markets and the regulatory reporting, particularly for financial institutions.
- The relationship between fair value and off-balance sheet accounting and the current crisis, both during and leading up to the crisis.

Appendix II, continued

- The findings and relevance of conclusions of various studies underway, including the US Securities and Exchange Commission study under the Emergency Economic Stabilization Act of 2008.
- The need for due process for accounting standard-setters and its implications on resolving emergency issues on a timely and inclusive basis.
- The independence of accounting standard-setters and governmental actions to the global financial crisis.

Advisory Group Structure and Meetings

The advisory group is chaired jointly by two co-chairs – one from each of Europe and North America. The advisory group is comprised of approximately 15-20 senior leaders with broad experience with international financial markets and an interest in the transparency of financial reporting information. Depending on the needs of the advisory group, subcommittees may be formed to consider various issues.

In order to provide the boards and others in the financial reporting system with the benefits of their advice, the advisory group will generally meet in public sessions, with webcasting facilities available to all interested parties. The advisory meetings also may involve private sessions, at the discretion of the co-chairs.

The advisory group meetings will be held in London and New York on a rotating basis. The first meeting will be in January 2009. Staff support for the advisory group is provided by the IASB and FASB. Also, advisory members are entitled to be reimbursed for actual out-of-pocket travel expenses incurred in connection with advisory group meetings as they may request if it is their employer's policy not to provide reimbursement for such costs.

Conduct of its Activities

Advisory group meetings are the primary mechanism that will be used to provide input to the IASB and FASB. The advisory group's role is not to reach a consensus or to vote on the issues that it considers at its meetings. For that reason, it is important to convene the advisory members as a group so that the boards can hear the individual members' views and members can hear and respond to each other's views.

The IASB and the FASB will provide the staff to document and communicate the input from the advisory group.

About the Advisory Group Co-Chairs

Harvey Goldschmid is a former Commissioner of the United States Securities and Exchange Commission (US SEC). Mr. Goldschmid is the Dwight Professor of Law at Columbia University, United States. He served as an SEC Commissioner between 2002 and 2005.

Hans Hoogervorst is the Chairman of the Netherlands Authority for the Financial Markets (AFM), the Dutch securities regulator. Mr. Hoogervorst also serves as Vice-Chairman of the Technical Committee of the International Organization of Securities Commissions (IOSCO) and is a former Minister of Finance in the Netherlands.

Appendix III: List of Interested Parties Who Responded to Questions Posed by the FCAG^{*}

Alex J. Pollock
Edward W. Trott
Christopher Whalen
Tax Justice Network
Disclosure Insight
Simon Bond
Shaun McGuire
Securities Commission of New Zealand
French Banking Federation
New York State Banking Department
Federation of European Accountants
Bundesverband Offentlicher Banken Deutschlands
Gina McMahon
American Academy of Actuaries
Ernst & Young Global Limited
Japanese Bankers Association
European Financial Reporting Advisory Group
Korea Accounting Standards Board
European Federation of Insurers and Reinsurers
Institute of Chartered Accountants of Scotland
British Bankers Association
BNP Paribas
KPMG IFRG Limited
Institute of International Finance
UK Accounting Standards Board
Association of British Insurers
Association of Chartered Certified Accountants
Deloitte LLP/Deloitte Touche Tohmatsu
International Swaps and Derivatives Association, Inc.
BDO Global Coordination B.V.
Group of 100
Group of North American Insurance Enterprises
Associazione Bancaria Italiana
PricewaterhouseCoopers LLP
Committee of European Banking Supervisors
Duff & Phelps Corporation
Banken Verband
International Actuarial Association
American Council of Life Insurers

^{*} In order received.

Appendix III, continued

UBS AG
Canadian Accounting Standards Board
The Value Alliance Company
Council of Institutional Investors
Hong Kong Institute of Certified Public Accountants
Institute of Chartered Accountants in England and Wales
European Banking Federation
HSBC Holdings PLC
Conseil National de la Comptabilité
Chartered Institute of Management Accountants
Australian Accounting Standards Board
European Association of Co-operative Banks
Basel Committee on Banking Supervision
International Organization of Securities Commissions
German Accounting Standards Board
International Valuation Standards Council
European Insurance CFO Forum

Appendix IV: Standards and Other Guidance Issued by the IASB and FASB to Date in Response to the Financial Crisis

- In September 2008, the FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees*.
- In October 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (following a joint reminder on this matter by the FASB and the SEC).
- In October 2008, the IASB issued as educational guidance the report of its expert advisory panel on fair value measurement when markets are no longer active.
- In October 2008, the IASB permitted the reclassification of specific financial instruments in some circumstances.
- In December 2008, the IASB published an exposure draft for a revised standard on Consolidation. (The FASB has since joined this project.)
- In December 2008, the FASB issued FSP FAS 140-4 and FIN 46(R)-8, *Disclosures by Public Entities (Enterprises) about Transfers of Financial Assets and Interests in Variable Interest Entities*, to improve disclosures on off-balance sheet items. (As noted below, their overhaul of this area was completed in June 2009.)
- In January 2009, the FASB issued FSP EITF 99-20-1, *Amendments to the Impairment Guidance of EITF Issue No. 99-20*, to make the guidance for impairment of interests in securitizations consistent with that of other debt securities.
- In March 2009, the IASB published an exposure draft on Derecognition. (The FASB has since joined this project.)
- In March 2009, the IASB issued *Improving Disclosures about Financial Instruments*, an amendment to IFRS 7, requiring disclosures similar to those in FAS 157, but also disclosure of transfers between all levels (not just Level 3) and certain sensitivity analysis disclosures.
- In April 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*; FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments*; and FSP FAS 115-2 and 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*.
- In May 2009, the IASB published an exposure draft on fair value measurement, to establish a single source of guidance within IFRS corresponding to FASB Statement 157.
- In June 2009, the FASB published revisions to its guidance on securitizations/off-balance sheet items through Statement 166, *Accounting for Transfers of Financial Assets – an amendment of FASB Statement No. 140*, and Statement 167, *Amendments to FASB Interpretation No. 46(R)*.
- In July 2009, as the first phase of replacing IAS 39, the IASB issued the exposure draft, *Financial Instruments: Classification and Measurement*, containing proposals to improve the classification and measurement of financial instruments.

Appendix V: 2008 IASB and FASB Progress Report on their 2006 Memorandum of Understanding

After their joint meeting in September 2002, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) issued the Norwalk Agreement, in which they “each acknowledged their commitment to the development of high quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, the FASB and the IASB pledged to use their best efforts (a) to make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programmes to ensure that once achieved, compatibility is maintained.”

At their meetings in April and October 2005, the FASB and the IASB reaffirmed that development of a common set of high quality global standards remains a strategic priority of both the FASB and the IASB.

In February 2006, the FASB and IASB issued a Memorandum of Understanding (MoU). The MoU set forth the relative priorities within the FASB-IASB joint work programme in the form of specific milestones to be reached by 2008. That MoU was based on three principles:

- Convergence of accounting standards can best be achieved through the development of high quality, common standards over time.
- Trying to eliminate differences between two standards that are in need of significant improvement is not the best use of the FASB’s and the IASB’s resources – instead, a new common standard should be developed that improves the financial information reported to investors.
- Serving the needs of investors means that the Boards should seek convergence by replacing standards in need of improvement with jointly developed new standards.

Based on the progress achieved by the Boards through 2007 and other factors, the SEC removed the reconciliation requirement for non-U.S. companies that are registered in the United States and use IFRSs as issued by the IASB. The European Commission is proposing that the European Union eliminate the possible need for U.S. companies with securities registered in European capital markets and with financial information prepared in accordance with U.S. GAAP to reconcile their accounts to IFRSs or provide other compensating disclosures. Additionally, a number of countries have adopted IFRSs on the basis that companies using IFRSs would be able to access capital more efficiently in the major economies throughout the world, which is now possible.

In developing the MoU published in 2006, the Boards agreed on priorities and established milestones only to 2008, even though they knew that many of the major standards level projects would not be complete by that date. At their joint meeting in April 2008, the Boards again affirmed their commitment to developing common, high quality standards, and agreed on a pathway to completing the MoU projects, including projected completion dates.

The following is a description of the agreed-upon pathway for completing the MoU projects that discusses separately short-term convergence projects and major joint projects. Also described is the relationship between those MoU projects and the joint conceptual framework project, which is not formally part of the MoU work plan.

Appendix V, continued

Short-term Convergence

The MoU set the goal of concluding by 2008 whether major differences in a few focused areas should be eliminated through one or more short-term projects and, if so, completing or substantially completing work in those areas. The status of those short-term projects follows:

- **Projects completed:** The FASB and the IASB issued standards on a number of short-term convergence projects. Bringing U.S. GAAP into line with IFRSs, the FASB issued new or amended standards that introduced a fair value option (SFAS 159) and adopted the IFRS approach to accounting for research and development assets acquired in a business combination (SFAS 141R). Converging IFRSs with U.S. GAAP, the IASB published new standards on borrowing costs (IAS 23 revised) and segment reporting (IFRS 8).
- **Ongoing short-term convergence:** The IASB published an Exposure Draft on joint arrangements (joint ventures) in September 2007. The IASB has begun considering the comments to the proposal soon and expects to release a final standard at the beginning of 2009. The IASB plans to publish a proposed standard on income taxes that would improve IAS 12, *Income Taxes*, and eliminate certain differences between IFRSs and U.S. GAAP.

The FASB plans to publish proposed standards on accounting and reporting for subsequent events in the second half of 2008. In the second half of 2008, the FASB will review its strategy for short-term convergence projects in light of the possibility that some or all U.S. public companies might be permitted or required to adopt IFRS at some future date. As part of that review, it will solicit input from U.S. constituents by issuing an Invitation to Comment containing the IASB's proposed replacement of IAS 12. At the conclusion of that review, it will decide whether to undertake projects that would eliminate differences in the accounting for taxes, investment properties, and research and development by adopting the relevant IFRS standards (IAS 12, as revised, IAS 40, and IAS 38).

- **Short-term convergence work deferred:** The Boards have chosen to defer completing projects on government grants and impairment until other work is complete.

Major Joint Projects

The MoU published in February 2006 set forth milestones to be achieved on major joint projects by 2008. At their April 2008 joint meeting, the Boards agreed on priorities and milestones to be achieved on those projects by 2011. The Boards also agreed that the goal of joint projects is to produce common, principles-based standards, subject to the required due process.

In seven of the 11 areas identified by the MoU, the Boards have either completed a common standard, reached similar conclusions, or are currently working jointly to develop a common, high quality standard. In the other four areas, the Boards are at different stages of developing their approach to the topic to address immediate areas of concern. Both Boards are following each other's progress to minimize differences in the near term and ease development of common standards over the longer term. For example, each Board is working separately to deliver timely improvements to their standards on consolidations and derecognition in response to the credit crisis. At the same time, both Boards will work together in 2008 to develop an approach that will ultimately lead to a common standard.

Appendix V, continued

Projects where the Boards are currently working jointly on areas identified for improvement in IFRSs and US GAAP				
Convergence topic	Progress expected to be achieved by 2008, as stated in the 2006 MOU	Current status	Estimated completion date	Next step(s)
1. Business combinations	To have issued converge standards (projected for 2007), the contents and effective dates of which to be determined after taking full account of comments received in response to the Exposure Drafts.	Project completed and common standards were published.	Project completed in 2007. FAS 141R was issued in 2007. The revisions to IFRS 3 were issued in 2008.	Post-implementation review after the revised standards have been applied for two years [review planned for the first half of 2012].
2. Financial Instruments (replacement of existing standards)	To have issued one or more due process documents relating to the accounting for financial instruments.	IASB: Discussion paper published in 2008. FASB: Invitation to comment published on IASB discussion paper. FASB issued Exposure Draft to simplify hedge accounting in mid- 2008.	To be determined.	Decision by late 2008 regarding the nature and scope of any proposed improvements to U.S. GAAP and IFRS, after considering comments on the IASB discussion paper and on the FASB Exposure Draft to simplify hedge accounting.
3. Financial statement presentation	To have issued one or more due process documents on the full range of topics in this project.	IASB: Issued a revision to IAS 1 in 2007. Joint Board deliberations are on-going.	2011	Preliminary views/discussion paper in third quarter of 2008.
4. Intangible assets	To have considered the results of the IASB's research project and made a decision about the scope and timing of a potential agenda project.	Inactive – the Boards decided in 2007 not to add a project to their joint agenda.	Not part of the active agenda.	Not part of the active agenda.
5. Leases	To have considered and made a decision about the scope and timing of a potential agenda project.	Project added to the joint agenda. Board deliberations are ongoing.	2011	Preliminary views/discussion paper to be published in the second half of 2008
6. Liabilities and equity distinctions	To have issued one or more due process documents relating to a proposed standard.	Preliminary views/discussion paper published in the first half of 2008.	2011	Exposure Draft in 2009.
7. Revenue recognition	To have issued one or more due process documents relating to a proposed comprehensive standard.	Joint Board deliberations are on-going.	2011	Preliminary views/discussion paper to be published in fourth quarter of 2008.

Appendix V, continued

Areas identified for improvement in IFRSs and US GAAP, where the Boards are at different stages in standard development and will seek a common standard				
Convergence topic	Progress expected to be achieved by 2008, as stated in the 2006 MOU	Current status	Estimated completion date	Next step(s)
8. Consolidations	To implement work aimed at the completed development of converged standards as a matter of high priority.	Both Boards to publish Exposure Drafts in 2008.	Both Boards to issue Final standards in 2009-2010.	Decision in 2008 on a strategy to develop a common standard.
9. Derecognition	To have issued a due process document relating to the results of staff research efforts.	Both Boards to publish Exposure Drafts in 2008 or early 2009.	Both Boards to issue Final standards in 2009-2010.	Decision in 2008 on a strategy to develop a common standard.
10. Fair value measurement	To have issued converged guidance aimed at providing consistency in the application of existing fair value requirements.	FASB: Completed standard. IASB: Issued Discussion Paper in 2007. Board deliberations are ongoing.	FASB: Standard issued in 2006. IASB: 2010	IASB: Exposure Draft in first half of 2009 FASB: Review FAS 157 in light of IASB's deliberations.
11. Post-employment benefits (including pensions)	To have issued one or more due process documents relating to a proposed standard.	FASB: Completed first stage of FASB-defined project. IASB: Discussion paper issued in March 2008.	IASB: 2011	IASB: Exposure draft in 2009, following consideration of comments on discussion paper.

Conceptual Framework

In setting this work programme initially in 2006 and again in updating the timetable in 2008, the Boards noted that the major joint projects will take account of the ongoing work of the FASB and the IASB on their joint project to improve and to bring about convergence of their respective Conceptual Frameworks. When updating the timetable in 2008, the Boards highlighted their continuing efforts to address, as part of the joint concepts project, issues relating to the range of measurement attributes (including cost and fair value) used in accounting standards.

Acknowledging Consultation Requirements

The FASB and the IASB also recognise the need to undertake this work in a manner that is consistent with their established due process, including consultation with interested parties on their ongoing joint efforts before reaching conclusions. Therefore, the timetable for completion is subject to change depending on input received throughout a project's development.

Appendix V, continued

Staggering of Effective Dates

Both Boards recognise that the work plan above anticipates the completion of several projects in 2010 and 2011. The Boards will consider staggering effective dates of standards to ensure an orderly transition to new standards. Consistent with its current practice, the IASB will consider permitting early adoption of its standards.

Other Topics Not on the MoU Work Programme

The FASB and the IASB note that their work programmes (including their joint work programme) are not limited to the items listed above, but remain committed to completing the MoU projects because they represent a significant step toward the goal of a common set of high quality standards. Both Boards place priority on the topics set out in the MoU, but will continue to devote resources, as appropriate, to other active projects and respond to other market demands.

