Responses to Questions Raised by IASB-US FASB Financial Crisis Advisory Group

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We understand that current financial crisis has brought about some criticisms against the existing financial accounting and reporting standards, in particular, some governments and market regulatory authorities have steered up pressures on accounting standards setters in various countries to reconsider the amendment of the requirements on "fair value" (including mark-to-market) accounting, as a solution to fix the current financial crisis. However we don't believe this is an appropriate move based on the following considerations;

1. We are strongly convinced that the major causes of current world-wide financial crisis are the over-leveraged structures for many financial instruments (including secondary mortgage financing and many complex financial derivative products) and a lack of effective regulatory and monitoring systems in the financial markets. It should be clarified that accounting (as a measurement and reporting system) along will never have the impact to generate any crisis in the financial markets;

2. The primary purpose of financial reporting is to provide relevant and reliable information about the financial positions and operating results of business and non-business organizations to assist users (primarily investors and creditors) to make rational investment and credit decisions (including assessing risks associated with specific investment decisions). Since the financial crisis has caused substantial value decline of financial instruments in the markets, accounting should timely reflect the actual changes in the values of financial assets and liabilities of the organizations concerned. Thus the "fair values" (including mark-to-market) accounting should be the reasonable basis, in contrast to historical cost, to fulfill the primary objective of financial accounting and reporting;

3. As for the difference caused by the so called 'through-the-cycle" or dynamic loan provisions, we believe such potential gains or losses should be recognized in the financial statements as they are highly relevant to assist investors and creditors in assessing the risk and values of the underlying loans or investments. Regarding the suggestions on varied treatments of the difference in a particular period, we support the option of "appropriation of equity outside of comprehensive income" if the

dramatic valuation changes leading to the impairment provisions are due to cycling effects. However, the difference should be recognized as other comprehensive income if there is sufficient evidence that the impairment of the underlying loans or investments is permanent rather than temporary in nature;

4. We agree with the view of some FCAG members that the issues surrounding accounting for off-balance items such as securitizations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Therefore IASB and FASB should make more efforts to develop standards or practical guidelines on how to reflect the potential impacts and risks of those off-balance sheet items on the financial positions of the business organizations in question. At least more specific and explicit disclosures related to those items should be required in the financial statements (maybe in the footnotes of financial statements) to enhance transparency and usefulness of the financial reporting for investors and creditors as well as other users;

5. It is true that the current mixed-attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is complex or even suboptimal. In theory, reporting the fair values of all financial instruments is desirable for the relevance to users in assessing the overall values and related risks of the underlying financial instruments. A problem is that the fair values of some financial instruments may not be conveniently and reliably determined due to a lack of active markets. Thus some other measurement attributes (such as present values of the future cash flows) may be used as a close surrogate for the fair values of the financial instruments. Nonetheless, most financial instruments should be measured at their fair values so long as the fair values can be conveniently and relatively reliably determined. In addition, the valuation base and assumptions for the measurement attributes other than fair values should be fully disclosed in the financial statement notes to ensure the understandability of the valuations;

6. We believe the high quality of accounting and reporting standards is most critical for the relevance and usefulness of financial reporting, thus logically coherent and consistent accounting and reporting standards should be a major concern for standard setters. Surely high-quality standards should be developed through “due process” and should not be easily and frequently overridden by “emergency issue.” Standard-setters must be able to resist political pressures and deliberate accounting standards following a coherent conceptual framework to develop high-quality standards that can best serve the interests of the financial statement users; and

7. It is understood that both IASB and the FASB are under great political pressures to amend the existing accounting and reporting standards (fair values or mark-to-market accounting in particular) to alleviate the negative effects of current financial crisis. Again it is argued that the basic objective of financial reporting is to reflect truthfully and fairly the actual financial positions rather than serving as a tool to fulfill specific political or economic goals. Accounting and reporting practices have economic consequences but setting accounting and reporting standards should emphasize on neutrality in order to ensure a wide acceptance by various interested groups or constituents of the financial reporting.