

FASB and IASB Should Work Together with all Deliberate Speed to Converge Accounting Principles for Financial Instruments

MBA RECOMMENDS

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) should work together to come up with converged, sound accounting principles for financial instruments. Those principles should be written so that the accounting accurately reflects the way the respective assets and liabilities are managed. Converged accounting principles will enable comparability of financial statements of financial institutions worldwide and prevent “accounting arbitrage.”

BACKGROUND

As a result of the G20 summit in April 2009, FASB and IASB undertook a project to amend and converge accounting standards for financial instruments by the end of 2011. Such accounting standards encompass classification and measurement of financial instruments, fair value accounting principles, hedge accounting, accounting for impairment, de-recognition of financial instruments, and consolidation of variable interest entities (VIEs). Since then, FASB and IASB continue to work on revising their own respective standards instead of meeting jointly to “do it once and do it right.” For example, FASB issued in June 2009 its standards for de-recognition and consolidation of VIEs. These principles will require financial institutions in the United States to put back on their balance sheets trillions of dollars of securitized assets previously accounted for off-balance sheet. It will have a ripple effect on the nation’s economy as these financial institutions struggle to come up with sufficient regulatory capital to support the increase in assets.

Accordingly, banks will curtail lending to consumers, home buyers, and small businesses in an attempt to shrink their respective balance sheets. IASB, in contrast, has issued exposure drafts for its proposed de-recognition and consolidation standards. Those drafts are dramatically different than their FASB counterparts. As these disparate standards are converged, the result will be for U.S. companies to have to make back-to-back changes in accounting principles. This will be confusing

to users of financial statements as assets and liabilities come on and off entities’ financial statements. It will also be very costly to preparers of financial statements from an operational cost standpoint. Further, on classification and measurement, IASB is proposing a mixed attribute model whereby assets to be held for long-term cash flows will be accounted at amortized cost. In contrast, FASB proposes to expand fair value accounting to all financial instruments in the balance sheet.

PRINCIPLES OF REFORM

In designing comprehensive, converged accounting standards, MBA recommends the following principles of reform:

- Do it once, and do it right. Don’t make U.S. companies go through back-to-back changes first to a revised U.S. standard and then to an international standard.
- Classification and measurement of financial instruments should be at fair value or amortized cost based on the underlying purpose of holding or issuing financial instruments. Assets held principally to realize cash flow from sale should be accounted for at fair value. Assets held principally to realize cash flow from payment of principal and interest over the life of the asset should be measured at amortized cost.
- A distressed reporting entity should not be allowed to mark its debt down to fair value based on the deterioration of

its own credit unless such debt forgiveness is probable and realizable at the measurement date.

- An entity shall use valuation techniques for fair value measures that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.
- In an economic or market situation where a normally active market for a financial instrument becomes inactive or illiquid, entities should use caution not to use observable inputs that represent distressed sales. In such situations, for assets designated to be sold in the short term, entities should estimate an exit price that a willing buyer would be willing to pay to a willing seller, including an appropriate liquidity discount. However, for entities who intend to hold the financial instrument beyond the short-term, the entity should have the discretion to estimate an intrinsic value for the instrument with appropriate discounts for inherent risks of holding the asset long-term like credit risk but not for the effects of liquidation at the reporting date.
- De-recognition and consolidation principles should be written in a way such that a reporting entity does not have to include in consolidated statement of financial position assets it does not own or liabilities it does not owe.
- An accounting recognition for impairment of future cash flows should be triggered by either an expected sale of the asset for a loss or a probable credit loss. Entities that hold securities, equity and / or debt securities, for the purpose of trading should record all changes in fair value through the income statement alleviating the need for impairment guidance.



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