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LETTER OF COMMENT NO. 149

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
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File Reference: Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b

Dear Mr. Golden:

The Financial Reporting Committee ("FRC") of the Institute of Management Accountants (IMA) appreciates the opportunity to provide its views on the Exposure Draft of Proposed FASB Staff Position No. FAS 115-a, FAS 124-a, and EITF 99-20-b *Recognition and Presentation of Other-Than-Temporary Impairments* (the "Exposure Draft"). FRC is the financial reporting technical committee of the IMA. It is comprised of representatives from preparers of financial statements of some of the largest companies in the world and the largest accounting firms in the world, along with valuation experts, accounting consultants, academics and analysts. FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

We appreciate the Board's decision to provide guidance on recognition of other-than-temporary impairments now rather than waiting for the conclusion of its joint project with the IASB on reducing complexity in reporting financial instruments. As noted in our comment letter on FSP EITF 99-20-a, we believe the current model in FASB Statement No. 115 *Accounting for Certain Investments in Debt and Equity Securities* results in companies recognizing other-than-temporary impairments that are significantly disproportionate to the expected credit losses. While we acknowledge the conclusion in the proposed FSP does not result in convergence with the impairment model in IAS 39 *Financial Instruments: Recognition and Measurement*, we note that the impairment models in IAS 39 and Statement 115 were already different. However, we continue to support the Board's convergence efforts and believe it should continue to pursue the financial instruments project with the IASB, even though that project may change the impairment model proposed in the Exposure Draft.

We generally agree with the approach adopted in the Exposure Draft of separating an other-than-temporary impairment loss into its credit loss and other loss components. We also agree with only recognizing the portion of the impairment loss relating to credit in earnings as long as the company does not intend to sell the security and it is more likely than not it will not be required to sell the security before the carrying value recovers. Further, we agree with the view in paragraph 6 of the Exposure Draft that the FSP will result in measures of interest income that are more meaningful when a company does not intend to sell the financial asset. Accordingly, we encourage the Board to finalize the proposed FSP. We have the following comments on the Exposure Draft that we believe will improve the clarity and operationality of the FSP.

Corporate Bonds

It is not clear how companies should apply the revised impairment model to investments in corporate bonds. It is unlikely that companies will be able to assess impairment of corporate bonds using the approach in FASB Statement No. 114 *Accounting by Creditors for Impairment of a Loan* as they will be able to for financial assets like mortgage-backed securities because of differences in the sources of cash flows and collateral backing the investments. We encourage the Board to provide its views on how a company could measure the amount of impairment related to credit losses on corporate bonds. For example, would it be appropriate to look to studies of the average recovery on defaulted bonds in the industry to which the bond issuer belongs? Or would a company assessing impairment need to estimate the cash flows it expects to receive from the specific issuer? We believe the former approach would provide a reasonable proxy of the probable credit loss on a corporate bond in the absence of evidence suggesting that the average recovery rate is either too low or too high in a particular circumstance.

Equity Securities

We believe the discussion about equity securities in the Exposure Draft may be confusing to certain constituents. We do not believe the proposed FSP significantly changes how a company should determine when an equity security is other-than-temporarily impaired. The only change we could identify relates to the proposed amendment of paragraph 14 of FASB Staff Position FAS 115-1 and FAS 124-1 *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. As amended, paragraph 14 would require a company to recognize an other-than-temporary impairment if it intends to sell the equity security or concludes it is more likely than not it will be required to sell the equity security before its market value has recovered. FSP FAS 115-1 and FAS 124-1 previously required a company to recognize a loss if the investor had decided to sell the impaired security and did not expect the fair value of the security to recover before the expected sale.

We think part of the confusion arises from the FSP not providing clear guidance on what a company should do when it concludes it does not intend to sell and it is more likely than not it will not be required to sell before the cost basis of the security has recovered. We believe the Board intends that a company would apply the guidance in SEC Staff Accounting Bulletin Topic 5M *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities* and AICPA Statement on Auditing Standards No. 92 *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* in that circumstance to determine if an other-than-

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temporary impairment exists. We believe the discussion in paragraph 7 of the Exposure Draft supports our view of the Board's intent. If our understanding is correct, we believe it would be helpful if the Board incorporated the guidance in paragraph 7 of the Exposure Draft into the standards section of the FSP.

Measurement of Credit Loss

Paragraph 13 of the Exposure Draft indicates that a company should recognize the impairment related to credit losses in earnings, but does not specify how a company should measure the credit loss. Paragraph A3(c) of the Exposure Draft states, in part:

> One way of estimating that amount would be to consider the measurement methodology in paragraphs 12-16 of FASB Statement No. 114 ....

While that indicates measuring the credit loss under an "incurred loss" model is clearly appropriate, it is not clear whether other methods, such as measuring a credit loss at fair value, are inappropriate. We encourage the Board to clarify its intent with respect to measurement of credit losses.

Intent and Ability to Hold

We believe the guidance in paragraph 12 of the Exposure Draft is not consistent with the proposed amendment of paragraph 14 of FSP FAS 115-1 and FAS 124-1 (paragraph A3(b) of the Exposure Draft). Paragraph 12 states, in part:

> If a decline in fair value below the amortized cost exists at the measurement date for a debt or equity security and the entity intends to sell the security or it is more likely than not that an entity will sell the debt or equity security before recovery of its cost basis, an other-than-temporary impairment exists.

Paragraph A3(b), however, states, in part:

> An other-than-temporary impairment of a debt or equity security has occurred if the investor intends to sell the security or it is more likely than not that the investor will be required to sell the security before recovery of its cost basis.

The inclusion of the phrase "will be required to sell" in paragraph A3(b) implies a different assessment than is implied by the use of the phrase "will sell" in paragraph 12. Based on the discussion in the Board handout for its March 16, 2009, meeting, we believe the Board intended to use the wording in paragraph A3(b). To avoid confusion, we believe the Board should conform the wording in paragraph 12 to the wording in paragraph A3(b).

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Interaction with FSP EITF 99-20-1

We are concerned that the wording in paragraph 15(b) of FSP FAS 115-1 and FAS 124-1, as amended, will lead to confusion about the amount of impairment a company should recognize when increased estimates of prepayments result in an adverse change in cash flows of a financial asset within the scope of FSP EITF 99-20-1 *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets.* The last sentence of paragraph 15(b) of FSP FAS 115-1 and FAS 124-1 appears to support a view that the Exposure Draft does not change how a company should measure impairments of financial assets within the scope of FSP EITF 99-20-1. In other words, a company will recognize an impairment loss in earnings whether the adverse change in cash flows results from an increase in expected prepayments or credit losses. If our understanding is correct, we suggest that the final FSP clarify that a company should account for decreases in the fair value of a security relating to increased expected prepayments in the same manner as it accounts for decreases in the fair value relating to credit losses. We also believe the final FSP should clarify whether a company should discount the estimated cash flows at a rate equal to the current yield used to accrete the beneficial interest as currently required by FSP EITF 99-20-1 or whether it might measure the credit loss using some other method.

In addition, we believe the Board should clarify whether the FSP changes when a company should recognize an impairment of financial assets within the scope of FSP EITF 99-20-1. A company recognizes impairment under the FSP when it is probable it will not collect all amounts due according to the contractual terms of a debt security, but currently recognizes impairment under FSP EITF 99-20-1 when it has an adverse change due to changes in either the timing or amount of estimated cash flows. We assume the Board did not intend to change the impairment trigger under FSP EITF 99-20-1, but believe it should clarify its intent.

Held to Maturity Debt Securities

We disagree with the Board's decision to require a company to recognize the impairment of a held-to-maturity security related to factors other than credit losses in Other Comprehensive Income ("OCI"). We believe that decision only makes the accounting for the securities overly complex. We assume that a company would be required to amortize the discount on the debt security created by the application of the FSP, similar to how a company accounts for the discount or premium on a debt security transferred from available for sale to held to maturity. In that case, paragraph 15(d) of Statement 115 requires the company to amortize the discount or premium resulting from accounting for the debt security at fair value in accordance with the guidance in FASB Statement No. 91 *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.* Because the amortization of the deferred loss in OCI should offset the effect of the amortization of the

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discount on the debt security, the application of the guidance in the Exposure Draft will result in a company incurring additional time and expense to do accounting that would not appear to improve the information provided to users of financial statements.

If the Board does not adopt our suggestion not to require recognition of the decline in the fair value of an impaired held to maturity debt security resulting from factors other than credit losses, we believe the Board should require recognition of other-than-temporary impairment only when credit losses are significant. By making that change, a minor shortfall in expected cash flows will not require a company to incur the costs of applying the complex accounting proposed in the Exposure Draft for little incremental benefit in the information conveyed to financial statement users.

Presentation

We disagree with the requirement in paragraph 16 of the Exposure Draft that a company recognize the gross impairment loss in earnings with an offset for impairment relating to factors other than expected or probable credit losses. We do not understand the objective of that disclosure and believe it is inconsistent with the conclusion in paragraph 13 of the Exposure Draft that a company recognizes only the credit loss component of the decline in fair value in earnings, supporting a view that the credit loss component is the only portion of the impairment that is other-than-temporary.

We believe the disclosure required by paragraph 17 of the Exposure Draft should provide users with sufficient information about the portion of a decline in the fair value of a security that a company recognized in OCI.

Effective Date

Although the scope of the proposed FSP is not as broad as the scope of proposed FSP FAS 157-e *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*, we believe the Board should permit, but not mandate, adoption of the FSP in the first quarter for companies with a calendar year end. If a company has already recognized an other-than-temporary impairment on a financial asset during the quarter, it would be required to recompute the impairment loss under the approach adopted in the FSP. In some cases, it may be difficult and time-consuming for a company to obtain the information necessary to measure the impairment under an expected cash flow approach. Further, if a company does not have other financial assets (loans) for which it assesses impairment using an expected cash flow approach, it would be required to obtain or develop models, determine the inputs at the time it concluded the asset was other-than-temporarily impaired, and test the controls over the models and the process to develop model inputs. Some companies may already have the ability to measure impairment under an "incurred loss" approach, but those that do not may find it difficult to measure the

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impairment of other-than-temporarily impaired financial assets and still be able to file their quarterly reports with the SEC in a timely manner.

Other Matters

Under the current impairment model, companies that have out-sourced management of all or a portion of their investments under agreements that provide the manager with discretion over purchases and sales of investments are unable to assert that they have the ability to hold until the carrying amount of a financial asset recovers. Accordingly, companies with such arrangements have recognized impairments for declines in the carrying amount of available for sale securities. It is not clear if the lower threshold in the proposed FSP would affect the accounting for those arrangements. We encourage the Board to clarify whether a company could assert that it is more likely than not it will not sell an impaired debt security when it has out-sourced investment decisions to a third party manager.

We note that the Board plans to discuss under what circumstances a company may reverse an other-than-temporary impairment through the income statement as part of another project on financial instruments. IAS 39 currently permits a company to reverse an impairment charge for debt securities through the income statement, resulting in a difference between the accounting under US GAAP and IFRS. We encourage the Board to address that difference, although we understand if it is not possible to do so in this short-term project.

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We would be pleased to discuss our comments further with the Board or the FASB staff. You may contact me at (513) 983-6666.

Sincerely,

Mick Homan
Chair, Financial Reporting Committee

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