Virginia Society of
Certified Public
Accountants

May 29, 2013

Technical Director
File Reference No. 2012-260
FASB
401 Merrit 7
P. O. Box 5116
Norwalk, CT 06856-5116

Submitted via email to director@fasb.org

Re: Proposed Accounting Standards Update — Financial Instruments — Credit Losses (Subtopic 825-15)

Dear Technical Director:

On behalf of the 11,000 members of the Virginia Society of CPAs (VSCPA), we appreciate the opportunity to respond to the "Invitation to Comment" on the Financial Accounting Standards Board's (FASB) Exposure Draft. The VSCPA's Accounting & Auditing Advisory Committee (A&A) has reviewed and discussed the proposed Accounting Standards Update *Financial Instruments — Credit Losses (Subtopic 825-15).* In general, the Committee supports FASB's efforts to improve the accounting standards regarding the measurement and recognition of credit losses on financial instruments.

The Committee has the following specific comment related to select questions as outlined in the "Questions for Respondents" and "Questions for All Respondents" sections of the proposal:

Question 1: Do you agree with the scope of financial assets that are included in the proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

> **Response:** No. The Committee believes that reinsurance receivables should be excluded from the scope of the Update because they are included in the scope of the FASB's *Insurance Contract Project*, which should provide the relevant accounting guidance for their recognition and subsequent measurement.

Question 2: The proposed amendments would remove the initial recognition threshold that currently exists in U.S. GAAP and, instead, view credit losses as an issue of "measurement" as opposed to an issue of "recognition" because the credit losses relate to cash flows that are already recognized on the balance sheet. Do you believe that removing the initial recognition threshold that currently exists in U.S. GAAP so that credit losses are recognized earlier provides more decision-useful information?

> **Response:** Yes. The Committee believes that concept of recognizing the current estimate of the present value of expected credit losses is an improvement over the current U.S. GAAP impairment models and would provide timelier, decision-useful information. We believe the current U.S. GAAP impairment models generally result in delayed recognition of changes in credit quality because they are viewed generally as "one-way" negative adjustments. We believe that current estimates of the present value of lifetime credit losses, while requiring significant judgment, will improve financial reporting by providing users of financial statements with management's estimates and disclosure regarding changes (favorable or unfavorable) in previous estimates. The Committee has concerns, however, regarding the practicability of implementing this measurement model on a consistent basis, especially for small- and medium-sized nonpublic entities.

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Question 6: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be amortized into and recognized as interest income over the life of the asset. To achieve this result, upon acquisition the initial estimate of expected credit losses would be recognized as an adjustment that increases the cost basis of the asset. Apart from this requirement, purchased credit-impaired assets would follow the same approach as non-purchased-credit impaired assets. That is, the allowance for credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you believe that using the same approach to recognize changes in the credit impairment allowance for purchased credit-impaired assets and non-purchased-credit-impaired assets provides decision-useful information? Do you believe that this is an improvement from the current model used for purchased credit-impaired assets?

> **Response:** Yes. The Committee believes that using the same approach to recognize changes in the credit impairment allowance for both purchased and non-purchased credit impaired assets provides more comparable reporting for similar types of financial assets. The Committee also believes that this is an improvement from the current model. Specifically, the proposed model improves the revenue recognition for interest income on purchased assets by eliminating the potentially artificial accretion of amounts into revenue and the asset for amounts that a company does not actually expect to collect. It should also result in a more timely and consistent recognition of changes in the allowance for credit losses, both favorable and unfavorable, during the period that management estimates that the changes in credit losses occur.

Question 7: As a practical expedient, the proposed amendments would allow an entity not to recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial asset is greater than (or equal to) the amortized cost amount of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. The proposed amendments would require an entity to disclose the amortized cost basis of assets that apply this practical expedient each period. Do you believe that the practical expedient from some financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income is reasonable? Why or why not?

> **Response:** No. The Committee does not believe a practical expedient should be permitted for entities to not recognize credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income. The exception undermines one of the basic objectives of the proposed standard: Comparable assets should be measured and reported in a comparable manner. If the expected credit losses are truly insignificant, a company can avail itself of the general materiality exception already in place for financial reporting without creating an additional reporting requirement. The Committee also believes that in general you cannot "fix" improper accounting with disclosure.

Question 8: The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost recovery method, as described in paragraph 825-15-25-10. Do you believe that this approach provides decision-useful information?

> **Response:** Yes. The Committee believes that the proposed approach provides an appropriately conservative model for revenue recognition and recovery under either the "cost-recovery basis" or "cash basis," as applicable and defined within paragraph 825-15-25-10. The Committee also agrees with the Board's objective to provide specific guidance for non-accrual assets to promote consistency and comparability between regulated and non-regulated entities.

Question 16: Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45-BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

Response: Yes. The Committee believes that the distinction between and accounting for troubled debt and nontroubled debt modifications continues to be relevant. The Committee believes that the concessions granted in a troubled debt restructuring should not result in a new effective interest rate for the continuation of modified instrument.

Question 20: Do you agree with the transition provision in this proposed Update? If not, why?

Response: Yes. We believe the cumulative effect provision is the only practicable way to implement this Update due to the inability to retrospectively establish subjective estimates for prior periods to incorporate reasonable and supportable forecasts.

Question 21: Do you agree that early adoption should not be permitted? If not, why?

Response: Yes. The Committee agrees that early adoption should not be permitted.

Question 22: Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

Response: No. We believe nonpublic entities should be permitted additional time to implement changes resulting from this update to allow industry practice to develop and to provide time for nonpublic entities to accumulate or obtain historical data.

Again, the VSCPA appreciates the opportunity to respond to this Exposure Draft. Please direct any questions or concerns to VSCPA Government Affairs Director Emily Walker at ewalker@vscpa.com or (804) 612-9428.

Sincerely,

Mike Wagner, CPA, CGFM
Chair

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