2012-260
Comment Letter No. 231

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Technical Director
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Re: File Reference No. 2012-260. Request for Public Comment: Proposed Financial Accounting Standard, *Financial Instruments – Credit Losses*

Plante & Moran PLLC is a registered public accounting firm serving community banks and credit unions. We appreciate the opportunity to respond and provide our views to the Financial Accounting Standards Board (FASB) proposed financial accounting standard, *Financial Instruments – Credit Losses*.

We have very significant questions about the proposed ASU as it has been constructed. By migrating to a model in which the goal is to anticipate future losses and recognize them currently, its methodologies are inconsistent with established principles of accounting theory and the conceptual framework. We believe it is excessively influenced by the goals of regulators, which are not necessarily consistent with unbiased financial reporting.

In early 2008, when entities and their auditors were evaluating 2007 reserves, no one could have possibly foreseen events that would subsequently occur in 2008 in 2009. There could have been no "reasonable and supportable" forecast that would have projected the losses that did subsequently happen. The crux of the problem was not an incurred versus expected loss approach to reserves, but rather that the financial system simply had too many assets for which no reserve methodology would have been adequate. For some banks, the incurred loss reserves worked just fine, and for many banks no impairment methodology would have helped because the fundamental failure was one of underwriting, not reserving.

There are economic downturns and companies do lose money and some will go out of business. The fact that those downturns are unpredictable and rarely anticipated is a fact that would be difficult to fix with an accounting standard. Trying to ease the pain by promulgating accounting standard that essentially mandates income smoothing by accelerating future losses into current periods is a retreat in the face of pressure to do something to prevent future surprises.

The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectibility of the financial assets remaining contractual cash flows. We agree the credit losses should be recorded when they are expected, but the life-of-loan projection required by the current expected credit loss model in

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the ED requires projections farther into the future than most would be reasonably capable of making with any level of reliability. Operationally, this will require an accrual for losses that are neither expected based on current facts and circumstances nor reliably determinable. On the spectrum of incurred, expected, and possible credit losses, the more distant the time horizon over which losses are estimated, the less "expected" in the more merely "possible" they become. Beyond the horizon of 24 months at the most, and more commonly between 12 and 18 months, credit losses become so speculative that best practice and common sense suggest creation of a reserve cannot be supported by the existing conceptual framework.

COMMENTS OF SPECIFIC PROVISIONS

Reasonable and supportable forecasts

The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. While management of community banks and credit unions have been able to gather and analyze the necessary data to support their historical loss experience for relevant loan types and can adequately support their assessment of past events, current conditions and borrower creditworthiness under the incurred loss model, the limited resources available to these institutions could mean it will take several years to obtain sufficient details to identify trends in loss cycles for each loan type sufficient to serve as a basis for preparing reasonable and supportable future forecasts. The recent financial crisis will only make this task more difficult as recent historical loss data more closely resembles a "worst case scenario" so institutions could require many more years of detailed historical data in order to establish the solid foundation required to accurately prepare reasonable and supportable forecasts of the future.

In addition, at the onset of the recent financial crisis, community banks and credit unions were widely criticized for not supporting or updating, in a timely manner, qualitative factors utilized in their incurred loss models which prompted regulators to encourage the shortening of the aggregate historical loss period used as the basis for allowance calculations in an effort to compensate for perceived inadequate reserves. If institutions weren't capable of adequately updating or supporting sufficient qualitative factors, intended to adjust historical loss experience to the current environment, then we anticipate that management of community banks and credit unions will struggle with the more difficult task of adequately supporting their forecast of expected losses for future periods. The range of "reasonable and supportable" projections will be as wide as the Grand Canyon and an auditor's nightmare – a PCAOB inspection finding waiting to happen unless substantially more guidance is given to what constitutes "supportable."

Most likely outcome

The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome. In our opinion, this has significant operability issues, and therefore, auditing concerns. It is simply an unnecessary complexity. We cannot understand why most likely outcome is not sufficient.

Purchased credit-impaired assets

We agree with the conclusion that for purchased credit impaired financial assets, the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition should not be amortized into and recognized as interest income over the life of the asset but rather established as an initial estimate of expected credit losses at the time of purchase.

Fair Value – Other Comprehensive Income Practical Expedient

Paragraph 825-15-25-2 of the proposed standard provides a practical expedient to not require an allowance for expected credit losses of financial assets. The practical expedient would only be allowed when the fair value of the asset is greater than or equal to the amortized cost and the expected credit losses are insignificant. We believe that requiring both the fair value of the financial asset to exceed the amortized cost basis and the expected credit losses to be insignificant is unnecessarily restrictive. In our opinion, if either of these two criteria were present, the practical expedient should be available to preparers.

In order to assist in consistent application, we believe it would helpful if the proposed standard were to provide guidance regarding how financial statement preparers should interpret the measurement of "insignificant" expected credit losses. Further, the applicability of the practical expedient is currently limited to financial assets measured at fair value with changes recognized in other comprehensive income. The result of this limitation could result in identical financial instruments having different amounts of expected credit losses recognized simply because one is recognized at fair value with changes in fair value recognized in other comprehensive income and the other is carried at amortized cost. As a result of these observations, we believe clarification of the practical expedient by the Board will allow for the implementation to be applied and reported consistently among entities.

Nonaccrual Principle

Paragraph 825-15-25-11 of the proposed standard provides guidance on the method of interest income recognition when the collection of both principal and interest are no longer in doubt. The proposed standard does not provide guidance on the treatment of previously received interest payments that were applied on the cost recovery method when the instrument can be restored to accrual. Accordingly, we recommend the Board clarify the treatment of previously received interest payments when circumstances indicate that the collection of both principal and interest are probable.

Disclosures

The proposed standard requires significantly expanded disclosures for both financial assets and debt instruments. We believe these expanded disclosures will require entities to devote substantial time and resources in order to comply with these new requirements. The proposed standard does not differentiate the disclosure requirements for public and non-public entities. Given the differences between the users of financial statements for public and non-public entities, we believe the Board should consider whether all disclosure requirements should be required for non-public entities. We believe the Board should work with the Private Company Council to determine which disclosures are most relevant to the users of the financial statements for non-public entities. We believe this will allow

the Board to develop disclosure requirements for non-public companies which are relevant to the users of the financial statements without placing an undue burden on the entities.

Thank you again for the opportunity to comment on this exposure draft. We would be pleased to respond to any questions the Board or its staff may have about these comments. Please direct any questions to Gregory Coursen, Director of Professional Standards, at 248-223-3360.

Plante & Moran