

June 17, 2010

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File Reference No. 1810-100  
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Although I believe the approach in the ED will produce significantly more useful financial reporting than IFRS 9, the ED approach can be simplified and improved. I hope the FASB (and ultimately the IASB) will act with true independence to develop accounting guidance for financial instruments for the benefit of the capital markets. Unfortunately I believe IFRS 9 was developed based on not threatening the IASB's franchise with the European Union rather than the opportunity to develop a high quality standard that could be used globally.

In the following section I will describe the perspective from which my comments are made and my bias and beliefs about accounting standard setting. My hope is that this section will help the reader understand my comments and evaluate them.

#### My Perspective, Bias and Beliefs

I served as an FASB Board member for 8 years and I believe I appropriately weighted my experience as an auditor in my standard-setting activities for 7 of those years. To me the experience as an auditor is quite similar to the experience of a preparer. In the final 7 years of my service the weighting of my auditor experience became secondary to the weight given to providing useful information to the users of financial statements.

Prior to becoming a Board member I served on the EITF for 7 years and a few years on AcSEC. In those roles my auditor experience had the most weight. I was interested in developing implementation guidance within GAAP that preparers and auditors could apply that reduced the chances of being second-guessed.

It took about a year at the FASB for me to focus more on providing better information to users even if that information produced concerns for preparers and auditors. My concern about being second-guessed with respect to using fair value measurements for various assets and liabilities (especially for financial instruments) was overwhelmed by information that could be captured and communicated using a fair value measurement. With continued observation of financial reporting and enforcement, I believe fair value estimates, done objectively, are less likely to be second-guessed than many other parts of financial reporting.

I was involved in developing the definition, guidance and disclosures about fair value

measurement that is contained in SFAS 157. I believe SFAS 157 provides the means for useful, verifiable and consistent fair value estimates to be made. As with all guidance, if the person using the guidance does not apply it objectively and faithfully, the result will be flawed. Applying guidance objectively and faithfully depends on the integrity of preparers, auditors, and in many cases, the SEC.

During my service on the FASB I observed that preparers, auditors and users resist change. Listening, even if done intently, to users is not where the responsibility of a Board member ends. Users many times do not like the idea of learning how to use new, more, and/or better information. Many times they believe they have learned how to overcome the need for this information and feel that their ability is a competitive advantage. To me a Board member who has had experience as a preparer or auditor is in the best position to use that experience to develop accounting standards based on how financial events can be captured in accounting systems and ultimately be usefully communicated in the financial statements. Listening has to be accompanied with evaluation, vision and a commitment to provide what is expected to **ULTIMATELY** be the best information for users.

I believe the objective of financial statements is to communicate information to the capital markets. Financial statements and accounting standards are **NOT** part of a government's fiscal or monetary policies. They are not like a government's laws designed to promote specific behaviors. High quality accounting standards should produce neutral information to be communicated to the users of the financial statements. It is the users (capital markets) that decide what actions they chose to take. High quality standards should not create accounting incentives that affect business decisions.

Accounting standards and financial statements also are **NOT** part of a regulators tools that they use to achieve their objectives. You have probably heard and read about some regulators and bankers calling for standards to produce counter-cyclical information to influence business and capital market decisions to avoid over or under lending and to flatten the valuation of assets and liabilities. What would counter-cyclical information be? Would it not be false information designed to produce a behavior selected by someone other than the user of the information? Regulators have the ability to directly access information and create rules they believe they need to meet their objectives. They should not try to force accounting standard setters to accommodate their goals at the expense of providing high quality information to the capital markets.

I believe financial statements should report information about the "Value" of expected future cash flows related to financial instruments and information about the contractual cash flows upon which that value is based. Financial instruments, especially debt instruments (both assets and liabilities) have features that make a fair value measurement the obvious choice for providing value information. A debt instrument states the rights and obligations of the future stream of cash flows and many times have limited cash flow variability. This is unlike most non-financial assets and liabilities. Also, there are significant timely observable inputs (both direct and indirect) on which to make an estimate of fair value for debt instruments.

Fair value estimates of debt instruments are based on either the instrument's (a) contractual cash flows discounted at an appropriate discount rate or (b) the instrument's probability-weighted

expected cash flows discounted at an appropriate discount rate. The appropriate discount rate for the (a) situation include the following main factors:

- (1) An expected “loss” factor to cover contractual amounts not expected to be made.
- (2) A “Risk Premium” that is required by the holder of the instrument as compensation for accepting the uncertainty about the amount and timing of the actual cash flows.  
and
- (3) A charge for the “time value of money.”

The appropriate discount rate for (b) situations is the same as for (a) situations except factor (1) is excluded since it is considered in determining the probability-weighted expected cash flows. I believe the (a) situation will cover most of the fair value estimates that are proposed for the bank loan and mortgage portfolios that are the most controversial element of this ED. Additionally it is (a) situations where the most observable inputs are available.

Fair value estimates are not a prediction of a future value or of the ultimate amount of a financial instrument’s cash flows. Those measurements are based on what future events will occur and how the factors affecting the discount rate will change in the future. A financial instrument’s fair value is a point-in-time measurement that will change as the factors in the discount rate (and/or probability-weighted expected cash flows) change.

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Although I believe all financial instruments should be reported at value using a fair value measurement and that using a “business strategy” to determine where to display the changes in fair values is suboptimal, my comments will accept this approach. The comments are intended to improve the use of a FV-OCI display for assets and to make the use of fair value for liabilities more clear.

#### Comments on the ED Approach

1. The ED is filled with “may” and “ifs” and different guidance that depend on the classification of identical debt instruments. Many times an accounting treatment is stated but you have to evaluate statements made later in the ED to determine the treatments applicability. Most importantly, the ED approach does not eliminate complexities in existing GAAP that should be eliminated and creates unnecessary new complexities. The following identifies complexities that should be eliminated.

- A. Why have different initial measurements for debt instruments in FV-OCI and FV-NI? Why have different treatment of fees and costs? Why retain the accounting guidance in SFAS 91 that is not consistent with the Conceptual Framework?

I believe having the same initial measurement for all debt instruments held as assets and the same treatment of fees and costs will produce less complex accounting and more understandable information. Remember financial reporting is to communicate information to user; not to other accountants. In many cases the same type debt instruments will be classified in FV-OCI and FV-NI. The different classifications do not change the instruments themselves and the result of

having different guidance on initial measurement and fees and costs will not be obvious to the user.

SFAS 91 mainly was issued to deal with misclassification of interest as an upfront fee. It requires that fees, even if nonrefundable, be deferred. It also created rules on what costs incurred in the origination of the debt instrument is also deferred. The net debit or credit of the deferred fees and costs must be maintained in accounting systems and amortized or accreted over the life of the instrument. This accounting guidance results in a debt or credit that does not meet the definition of an asset or liability. It also makes the instrument's effective interest rate not a market interest rate.

Initially recording all debt instruments at fair value will deal with misclassifications of interest as fees. Look at Example 3 in the ED. Recording the origination of the loan (assuming the \$544 is the difference in the loan's fair value because of the below market interest rate) with the same treatment of initial measurement, fees and costs as FV-NI would be as follows:

(1) Cash	944	
Fee income		944
(2) Expenses	300	
Cash		300
(3) Loan		9,456
Initial FV adjustment expense	544	
Cash		10,000

The loan's effective interest rate will be the market rate of 5%. The recognition of the loan initially at its fair value transfers the misclassified fee to interest. This treatment is more straight forward and simpler than that required by the ED for FV-OCI instruments. It does not require the user to know and recognize the different treatments for numbers that look the same. Also it avoids the difficult issues and gaming of cost transactions to get cost deferred and simplifies the loan's record keeping.

What is the credit balance of \$100 in Example 3? It can't be a liability since there is no obligation. Does it affect the loan's fair value? Should it affect the measurement of the adjustment to fair value? On what basis is the \$100 recorded in OCI if the reason for having FV-OCI is to avoid the potential temporary fluctuations of the loan's fair value from affecting net income?

Using the FV-NI treatment will mean that all loans will be treated more consistently whether originated, purchased or acquired in a business combination. Numbers that appear to be based on similar transactions and representing similar items will be the same. Also the rule in paragraph 16(a) can be eliminated.

- B. Why should management of net income by recycling gains and losses that occurred in prior periods into the current period be continued? Isn't recycling gains and losses on sales of FV-OCI instruments inconsistent with the business strategy

approach? Isn't non-recycling needed if you don't have tainting or reclassification?

Accounting standards should NOT create accounting incentives that affect the timing or whether a transaction is done or not. Reporting realized gains and losses, including prior periods' unrealized gains and losses, as required by paragraph 91(c) creates such accounting incentives. Net income can be manipulated by deciding if a FV-OCI instrument is sold or not and if sold when it is sold.

This accounting incentive should be eliminated. Its elimination also seems to be required if tainting is not considered or reclassifications are not allowed. The information with respect to FV-OCI sales should be separately displayed in the FV-OCI section with a transfer out of OCI to retained earnings. The need to recycle to get realized gains or losses into retained earnings is a false argument.

I encourage you to read the Basis For Conclusions of SFAS 115 to see the 5 problems the Board was trying to address at that time. It acknowledges it was unable to deal with the last 2- GAINS TRADING and ACCOUNTING BASED ON INTENT. You have the opportunity to deal with those 2 in this project by eliminating recycling.

- C. Why continue to state an objective for the recognition and measurement of credit impairment of FV-OCI instruments that is not obtainable in an objective and consistent manner? Why make this area even more complex when a fair value measurements already captures this information?

Fair value measurements capture the most relevant, observable and verifiable information about changes in a debt instrument's expected cash flows. This seems to be supported to some extent by the ED, the Alternative Views and the IASB. The ED and the IASB only provides credit impairment guidance for non-FV-NI debt instruments. Many FV-NI debt instruments have more variable cash flows than instruments in FV-OCI and similar credit risks but separate recognition and measurement of credit impairments is not proposed for these instruments because it is not needed. In paragraph BC 244, the writers of the Alternative Views endorse the approach in the ED for recognizing and measuring credit impairments.

The proposed credit impairment recognition and measurement guidance for FV-OCI debt instruments is even more complex than the "incurred loss" and "Other than Temporary Impairment" models in current GAAP. The guidance calls for entity-specific predications of how current and past events will affect future events. This is certainly harder to audit and more subject to being second guessed than a fair value measurement. Also how is the user of this information going to evaluate and use this information?

Fair value measurements capture credit impairments. Eliminating the proposed guidance for separately recognizing and measuring credit impairments would eliminate most of paragraphs 36-74 of the ED and much of the proposed Implementation Guidance. As discussed in my article in the December 2009 edition of *Accounting Horizons*, information about amounts written-off and information about fair value measurements on a disaggregated basis will produce more objective, verifiable and useful information for users than current GAAP or the ED about

credit risks.

Also the use of fair value to initially record debt instruments as suggested in comment A and fair value to capture subsequent changes in expected cash flows eliminates the need to recognize a credit impairment at the origination of the debt instrument.

- D. Why complicate the recognition of interest income and move it further from contractual cash flows?

I believe a debt instrument's effective interest rate should be the rate that equates the instrument's contractual cash flows (or the probability-weighted expected cash flows based on initially recognizing the instrument when the instrument is initially recognized with a credit discount) and the instrument's initial fair value. Such effective interest rate should be the market rate for similar debt instruments. Because I believe changes in expected cash flows will be captured in fair value measurements, this effective interest rate will not need to be subsequently adjusted. This would extensively simplify the accounting and system demands for loans acquired with an initial credit discount. The complexity in Example 21 is eliminated.

I suggest that interest income be recognized by applying the instrument's effective interest rate to the instrument's amortized or accreted initial fair value. Uncertainty of collecting the accrued interest will be captured in the instrument's fair value measurement.

As discussed earlier, there would be no need to maintain records on the net deferred fees and origination costs. The debt instruments effective interest rate will reflect as interest any misclassified fees that are part of the instrument's market interest rate.

- E. Why net an intangible asset and a liability? Why create an approach for demand deposits that can only be described as the result of a calculation and not a measurement?

I believe the guidance on "Demand Deposit Liabilities" in paragraph 31 effectively nets an intangible asset that in current GAAP usually is recognized in a business combination against a liability. This treatment is flawed and contrary to any other accounting that I am aware of.

As discussed in SFAS 141, an intangible asset is many times acquired in the assumption of demand deposits and SFAS 142 requires that recognized intangible assets be recognized initially at fair value. I do not believe the result of applying paragraph 31 is consistent with current GAAP for intangible assets. This guidance is not being changed by this project .

I believe the Board proposes guidance on "Demand Deposit Liabilities" to accommodate a red herring raised by bankers. Bankers have argued that if loans are to be measured at fair value, demand deposits that they claim fund loans must also be measured at fair value to reflect offsetting affects.

I believe the bankers raise this issue because they did not think the FASB would allow demand deposits to be reported below the amount on deposit and thus would be able to argue that loans

should not be measured at fair value. The Board's attempt to deal with this red herring produces confusing information and will be a lightning rod against the use of fair value measurements when the number resulting from the proposed guidance is not a fair value measurement. Also I believe the sensitivity of interest rate changes on a core deposit intangible is much less than for loans because of the government protection of deposits. The proposed calculation mixes entity-specific costs with market rates to produce a number with little meaning.

I believe the fair value of a demand deposit is the amount that can be withdrawn on demand by the depositor. I do not believe this project should deal with the intangible asset.

- F. Why continue the complexity created by allowing fair value hedges for selected risks in financial instruments? Why require separation of effective and ineffective portions in a qualifying fair value hedge of a FV-OCI debt instrument?

As discussed in paragraphs BC234 and BC235, the Board considered various changes to fair value hedge accounting. However, I believe they missed a change that would both simplify fair value hedge accounting for financial instruments and improve financial reporting. I propose the following:

1. Eliminate the ability to select specific risks in FV-OCI instruments for fair value hedging.
2. Report the affect of a qualifying hedging item in the same place in the financial statement as the affect of the hedged debt instrument. Thus the change in fair value of the qualifying hedging item would be reported in the FV-OCI instrument area.

I consider the FV-OCI section of the statement of comprehensive income to be an integral part of reporting the results of operations. I would change the accounting for qualifying fair value hedging instruments to require the results of the fair value hedging (both the effective and ineffective portions) be displayed in FV-OCI.

- G. Why retain the equity method of accounting? Why double the requirements for the use of the equity method?

The equity method was created by accountants for accountants. I do not believe users understand the use of or the results of applying the equity method. However, I believe users understand reporting investees at fair value, and because an equity investment has significant variability in cash flows, fair value measurement is the appropriate measurement. I suggest the use of the equity method be eliminated and all non-consolidated equity investments be measured at fair value. Disclosures about the entity's relationships with significant investees, maybe similar to disclosures about non-consolidated VIEs, would be more effective communication to users than the results of the equity method.

One of the benefits of the Fair Value Option for financial instruments was the ability to eliminate the question of whether an investor had significant influence over the investee. The ED proposes to take this simplification away and to add a second subjective requirement with another set of

rules. This is unnecessary.

- H. Could we be make deciding which financial liabilities can be measured at fair value or amortized initial fair value any harder?

Although my preference is to measure all financial liabilities at fair value, I understand that many preparers, auditors and users find this treatment confusing and not useful. Therefore I believe the ED should be reorganized to separate the discussion of financial assets and financial liabilities.

The discussion of financial liabilities could then be focused and clearly articulate which financial liability are to be reported at amortized initial fair value and which are to be reported at fair value and where there is a choice.

For the same reasons as noted for financial assets in comment A, I believe all financial liabilities should initially be measured at fair value. All costs related to the issuance or modification of a financial liability should be expensed. Reporting the instrument initially at fair value would correct any misclassification of fees and interest.

I believe the Board should either require (or allow by retaining the Fair Value Option) all financial liabilities meeting the criteria in paragraph 21 to be accounted for at amortized initial fair value. The added criteria in paragraph 28(b) with its additional rules in paragraph 30 are confusing and will be difficult to apply. More importantly, I do not believe they are necessary. Let's have faith that preparers will try to produce useful financial statements.

2. The following are some comments on the ED proposal that are not needed simplifications:

- a. Is paragraph 24(b) stated correctly? Do you mean "accrued" interest?

b. With respect to debt instruments in FV-NI, I would require, on a disaggregated basis, disclosures in the foot notes of amortized initial fair value, accrued interest income, amounts written-off and the amount necessary to adjust to fair value. I believe this information will help users understand the type of debt instruments the entity holds and the fair value adjustments. Much like the Board learned from users about derivatives, a fair value measurement does not tell the whole story.

On the statement of financial position I would report derivatives related to the debt instruments in FV-NI next to the assets.

c. With respect to debt instruments in FV-OCI, I would display the items listed in b above on the face of the statement of financial position with disaggregated information in the foot notes. The derivatives related to these assets that have their adjustment to fair value reported in FV-OCI should be reported next to these assets on the statement of financial position.

d.  
not believe there should be a FV-OCI classification.

For financial liabilities, I do

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