



ILLINOIS CPA SOCIETY

March 31, 2011

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Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
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The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Supplementary Document *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Impairment* (Supplementary Document). The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual view of the members or the organizations with which they are affiliated. The organization and operating procedures of our Committee are outlined in Appendix A to this letter.

While we continue to support the continued efforts at convergence of US and International standards, we again express our concern as to the pace of this undertaking. We appreciate the political pressure being placed on both Boards and for that very reason believe that the major changes currently on the horizon deserve as much time as necessary to achieve field tested high quality accounting standards as opposed to merely the time necessary to achieve palatable compromise. We do not believe the world economy is currently disadvantaged by having different financial reporting standards. We do believe the Boards will gain credibility by resisting pressure to compromise in order to achieve convergence solely for the sake of meeting externally imposed deadlines. Our comments in this letter are offered as preliminary, consistent with the nature of the Supplementary Document. Our comments may change as the Boards continue their redeliberations of the various proposals in the original exposure drafts including the methods for measuring credit losses.

1. *Do you believe the proposed approach for recognition of impairment described in this supplementary document deals with this weakness (i.e. delayed recognition of expected credit losses)? If not, how do you believe the proposed model should be revised and why?*

We believe it is an improvement over the previously issued IASB model which appears to spread those losses into future periods, hiding them in net interest income. The revised approach at least captures near-term losses and thus is an improvement. We also believe the time-proportional basis for longer term instruments for which impairment is not an immediate event but for which impairment at some point over its life is an historically based probability is preferable to a model which requires life-time loss expectation to be currently accrued.

2. *Is the impairment model proposed in the supplementary document at least as operational for closed portfolios and other instruments as it is for open portfolios? Why or why not?*

We believe this approach is at least as operational for closed portfolios as it is for open portfolios. We believe that the identification of financial assets that are performing poorly and are subject to increased risk of non-collection in accordance with their terms is consistent with the manner in which managements currently manage their financial instrument portfolios.

3. *Do you agree that for financial assets in the ‘good book’ it is appropriate to recognize the impairment allowance using the proposed approach described above? Why or why not?*

We did not agree with the approach as proposed by the IASB last summer as we believe it inappropriately hides impairment losses in net interest income giving less information to users. We expect, however, that any transfers from the “good book” to the “bad book” would be accompanied by a current period charge reflecting the expectation of potential loss in the foreseeable future and that such potential loss would be reflected as impairment rather than being buried in net interest income. In other words, we believe that a change in status from “good” to “bad” for some instruments in a portfolio would be evidenced by an increase in the amount of loss expected in the foreseeable future. The allowance related to the “good book” would be adjusted as it has been to that point, consistent with the provisions of this standard. The additional charge we would expect to exist with respect to those instruments being transferred to the “bad book” should not be buried as an adjustment to net interest income but presented separately as a provision for the impairment of those instruments.

4. *Would the proposed approach to determining the impairment allowance on a time-proportional basis be operational? Why or why not?*

We believe that for many portfolios, an assessment based on historical experience is made of losses expected over the life of the portfolio. For such portfolios, a methodology based on that assessment does not appear to be burdensome. For those portfolios where such assessments have historically not been made, due either to standard practice or absence of data on which to base such assessments, we have no information on which to base a determination as to whether the development of such assessments is or is not operational.

Some have expressed concern over the requirement to specifically compute a floor. We believe that in developing information for the computation of the allowance on a time-proportional basis, management will likely be able to determine the likelihood that such a floor would exceed the allowance based on a time-proportional basis. We recommend the Boards only require explicit determination of a floor amount when the information used in the determination of the time-proportional amount indicates it more likely than not that the floor amount would be greater.

We also suggest the Boards consider several points, specifically:

- whether similar portfolios could be aggregated for the purpose of determining an allowance
- whether there should be any unique guidance for “indefinite lived” portfolios, such as credit card portfolios
- whether the allowances “attach” to the portfolios if the instruments are securitized or are reset to zero at the date of transfer with the instruments in the portfolio presented individually at fair value
- whether the use of a straight-line approach or a discounted approach will be an overall policy choice or determined on an individual portfolio basis
- the disclosures required as to management’s definition of the “foreseeable future” for the purpose of this exercise and how that may relate to the development of other forward looking estimates
- the disclosures required as to the criteria used by management in determining identification of instruments and timing of transfers into or out of the bad book

5. *Would the proposed approach provide information that is useful for decision-making? If not, how would you modify the proposal?*

We believe that judgments about risk horizons, economic outlooks, customer collections management, and so forth are all useful in understanding how management actually manages the risk in a business. To the extent disclosures along these lines are not simply boiler-plate disclosures, we believe the information will likely be useful.

We also recognize that the approach outlined may result in reduced comparability among reporting entities and to the extent such reduction is reflective of the underlying economics we believe it is appropriate. We believe users would benefit by seeing the comparative abilities among managements to monitor and make judgments about credit risk and collectability and believe a model that incorporates more of managements' actual judgments is superior to one that results in excessively large allowances that permit those with less skill to hide their mistakes. Accordingly, we encourage the Boards to be open to such differences, to require disclosures that allow users to judge management performance in the light of its planned or promised performance, and to have the patience to allow the market place to evaluate such performance over time.

6. *Is the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance clearly described? If not, how could it be described more clearly?*

We believe that management is well able to judge those financial assets that are not performing in accordance with their contractual terms such that they deserve attention apart from the other financial assets in the portfolio. We further believe that such financial assets are routinely monitored by company credit and collections person. Accordingly we believe this approach will mirror current practice.

We note that the term "doubtful" (in B4) may have different meanings in different settings. Some of our members with experience in the US banking industry note that "doubtful" is a term of art used in assessing credit impairment of commercial loans and indicates a loss potential of at least 50% of the principal amount of the loan. They note that such loans would likely be categorized as being in the "bad book". The Boards should determine whether this or similar terms would suggest an implied "bright line" for the transfer of instruments from the good to the bad book. Additionally, methodologies for identifying non-performing loans, doubtful loans, or other similarly labeled instruments likely vary across countries and industries. We recommend the Boards conduct field testing to understand how identification will occur in practice across these various jurisdictions to assess the impact on that identification of the terminology used in the standard.

7. *Is the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance operational and/or auditable? If not, how could it be made more operational and/or auditable?*

We believe it is both operational and auditable as it appears to be consistent with how the entity manages its portfolios and their credit risks.

8. *Do you agree with the proposed requirement to differentiate between the two groups (i.e. 'good book' and 'bad book') for the purpose of determining the impairment allowance? If not, what requirement would you propose and why?*

We agree, however, we believe the way in which portfolios are managed varies across entities and is influenced by management style and by regulators. Accordingly, the Boards should conduct field testing to validate this proposed requirement. Specifically, the Boards should understand how management will

determine the composition of the bad book as well as the criteria for transfers in or out.

9. *The boards are seeking comment with respect to the minimum allowance amount (floor) that would be required under this proposed model. Specifically, on the following issues:*
- a. *Do you agree with the proposal to require a floor for the impairment allowance related to the ‘good book’? Why or why not?*
 - b. *Alternatively, do you believe that an entity should be required to invoke a floor for the impairment allowance related to the ‘good book’ only in circumstances in which there is evidence of an early loss pattern?*
 - c. *If you agree with a proposed minimum allowance amount, do you further agree that it should be determined on the basis of losses expected to occur within the foreseeable future (and no less than twelve months)? Why or why not? If you disagree, how would you prefer the minimum allowance to be determined and why?*
 - d. *For the foreseeable future, would the period considered in developing the expected loss estimate change on the basis of changes in economic conditions?*
 - e. *Do you believe that the foreseeable future period (for purposes of a credit impairment model) is typically a period greater than twelve months? Why or why not? Please provide data to support your response, including details of particular portfolios for which you believe this will be the case.*
 - f. *If you agree that the foreseeable future is typically a period greater than twelve months, in order to facilitate comparability, do you believe that a ‘ceiling’ should be established for determining the amount of credit impairment to be recognized under the ‘floor’ requirement (for example, no more than three years after an entity’s reporting date)? If so, please provide data and/or reasons to support your response.*

While we do agree with the proposal to require a floor for the impairment allowance we do not believe a minimum time horizon should be specified for determining the foreseeable future. While it may seem logical to assume that any group of managers can look into the future for at least twelve months, we note that in times of uncertainty or in certain developing economies a twelve month horizon is not the foreseeable future. We note the “foreseeable future” in the United States for the first few months following 9/11 was not clearly twelve months. Companies currently doing business in the middle-east or in northern Africa may also have foreseeable futures that are much shorter than twelve months. For the same reason, we also do not believe a maximum horizon should be specified.

As these standards are expected to apply worldwide, we believe that judgments as to the appropriate horizon should be left to management and disclosed giving users more useful information as to the riskiness of the environment in which the company conducts its business. We believe that the foreseeable future should of necessity imply that the foreseeable period would change over time and among reporting entities. For this reason, disclosure of management’s definition of that horizon is imperative. The information that users will obtain about management’s performance over time, its ability to assess and manage risk, and its ability to plan for the future will outweigh the benefits of specifying a computational corridor around the determination of the allowance.

10. *Do you believe that the floor will typically be equal to or higher than the amount calculated in accordance with paragraph 2(a) (i)? Please provide data and/or reasons to support your response, including details of particular portfolios for which you believe this will be the case.*

We have no reason to expect that the time-proportional credit losses will always be less than the loss expected in the foreseeable future which your question implies, nor do we understand why it should make a difference so long as the greater of the two amounts is recorded. As noted above, we believe that management will have information to determine whether there is a likelihood that a floor will be required and suggest the Boards consider requiring computation of the floor when it is more likely than not that the amount so computed will exceed the time-proportionally determined amount. However, if it

is the case that the floor is typically equal to or greater than the time- proportional amount, then computation of the latter should not be required.

We recommend the Boards conduct field testing specifically to understand the relationship between amounts computed based on the foreseeable future and based on the time-proportional approach. It is possible, for example, that if the floor exceeds the time-proportional amount the good book contains instruments which should be transferred to the bad book and only field testing will allow the Boards to understand that.

11. *The boards are seeking comment with respect to the flexibility related to using discounted amounts. Specifically, on the following issues:*
- a. *Do you agree with the flexibility permitted to use either a discounted or undiscounted estimate when applying the proposed approach described in paragraph B8 (a)? Why or why not?*
 - b. *Do you agree with permitting flexibility in the selection of a discount rate when using a discounted expected loss amount? Why or why not?*

Our committee was unable to reach a consensus on this issue. Some of our members prefer an undiscounted approach believing such approach would lead to greater comparability. Others believe a discounted approach is preferable and more representationally faithful to the underlying economics. Yet others believe flexibility is preferable. Accordingly, the Boards should conduct additional field testing to ascertain whether one approach is truly preferable.

12. *Would you prefer the IASB's approach for open portfolios of financial assets measured at amortized cost to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the IASB's approach (i.e. to recognize expected credit losses over the life of the assets)? Why or why not?*

We prefer the approach in this document.

13. *Would you prefer the FASB's approach for assets in the scope of this document to the common proposal in this document? Why or why not? If you would not prefer this specific approach, do you prefer the general concept of the FASB's approach (i.e. to recognize currently credit losses expected to occur in the foreseeable future)? Why or why not?*

We prefer the approach in this document.

We appreciate the opportunity to offer our comments.

Sincerely,

Reva Steinberg, CPA

Chair, Accounting Principles Committee

Jeffery Watson, CPA

Vice-chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2010-2011

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:

Large: (national & regional)

Robert A. Dombrowski, CPA	McGladrey & Pullen LLP
John A. Hepp, CPA	Grant Thornton LLP
Alvin W. Herbert, Jr., CPA	Retired/Clifton Gunderson LLP
Scott G. Lehman, CPA	Crowe Horwath LLP
Matthew G. Mitzen, CPA	Blackman Kallick LLP
Reva B. Steinberg, CPA	BDO USA LLP
Jeffery P. Watson, CPA	Blackman Kallick LLP

Medium: (more than 40 professionals)

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Marvin A. Gordon, CPA	Frost, Ruttenberg & Rothblatt, P.C.
Ronald R. Knakmuhs, CPA	Miller, Cooper & Co. Ltd.
Jennifer L. Williamson, CPA	Ostrow Reisen Berk & Abrams Ltd.

Small: (less than 40 professionals)

Barbara Dennison, CPA	Selden Fox, Ltd.
Kathleen A. Musial, CPA	BIK & Co, LLP
Michael D. Pakter, CPA	Gould & Pakter Associates LLC

Industry:

Christopher M. Denver, CPA	Solomon Edwards Group LLC
Kenneth J. Frederickson, CPA	NGL
Farah. Hollenbeck, CPA	Hospira, Inc.
James B. Lindsey, CPA	TTX Company
Michael J. Maffei, CPA	GATX Corporation
Jacob R. Mrugacz, CPA	U.S. Cellular Telephone & Data Systems
Karen R. Page, CPA	David Lewis Co.
Anthony Peters, CPA	McDonald's Corporation

Educators:

James L. Fuehrmeyer, Jr. CPA	University of Notre Dame
Laine E. Malmquist, CPA	Judson University
Leonard C. Soffer, CPA	University of Chicago

Staff Representative:

Paul E. Pierson, CPA	Illinois CPA Society
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