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Background

Orth, Chakler, Murnane & Company, CPAs, provides audit and consulting services to the credit union industry. One hundred percent (100%) of our clients are credit unions and credit union service organizations (CUSOs). Each of the firm's Partners has relevant auditing and consulting experience in the credit union industry ranging from 15 to over 30 years and our firm is consistently ranked by Callahan & Associates as one of the nation's leading CPA firms providing audit services to credit unions. The 2012 *Guide to Credit Union Auditors* published by Callahan & Associates ranks our firm number two in the nation with respect to auditing credit unions with total assets over \$40 million. We currently perform the opinion audit for approximately 130 credit unions, 6 corporate credit unions, 25 CUSOs and 65 pension/401(k) plans throughout the country.

Overview

In preparing our response to the Financial Accounting Standards Board (FASB), we considered the cost to prepare the disclosures as well as the additional costs that will be incurred to audit the disclosures. We also considered the demand for this information from the financial statement users.

History

Historically, the financial statement preparer has not been required to present forward looking projections within the financial statements. Rather, the financial statements and disclosures have presented factual, historical financial information to the reader of the financial statements. This information was to be used by the financial statement reader to perform their own analysis and projections to evaluate the company.

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The proposed interest rate risk disclosure requirements would require the presentation of forward looking projections in the financial statements. This would seem to be the first venture into providing projections or proforma information in the financial statements.

As a minimum, the modeling needed to present the interest rate risk disclosures requires significant assumptions about prepayment speeds, movements in the interest rate market, and the intangible estimate of the decay rate of non-maturity deposits under various scenarios.

General Conclusions

We do not believe that it is the responsibility of the financial statement preparer to present forward looking projections such as the proposed interest rate risk disclosure in the financial statements. Projections are inherently inaccurate and would likely mislead the reader about a financial institution's projected performance over a future period of time. Additionally, there appears to be very little demand for this information by the users of credit union financial statements.

While we understand the importance of conveying the risks associated with liquidity and interest rate risks, it may be possible to accomplish this goal with more qualitative discussion versus quantitatively. As discussed in the "Summary" section of the proposed Accounting Standards Update (ASU), there is no clear measurement attribute that would convey to the user of the financial statements complete information about a financial instrument's inherent risks and the broader risks to which an entity is exposed.

While the examples in the proposed statement give the impression that the information is clear, there are many assumptions underlying these examples which make the information misleading. The assumptions underlying the models used to project this information are voluminous and it would be extremely difficult and time consuming to present all of the assumptions in a manner that is clear and concise to the reader of the financial statements.

While liquidity risk and interest rate risk information is required in the management discussion and analysis (MD&A) section of the financial statements for public company's meeting the Securities and Exchange Commission's (SEC) rules, the need to present this information in non-public or credit union financial statements does not appear to exist. The Credit Union National Association (CUNA), a trade group for credit unions, has queried the CFOs of their constituents and found that of 114 respondents, 38 have had less than five requests from the general membership for the audited financial statements which include all the required footnote information. Only one respondent stated that they had a request for interest rate risk information and only four respondents noted that they had a request for liquidity risk information.

The users of credit union financial statements beyond the Board of Directors, Audit (Supervisory) Committee, and management are the regulators, creditors, and occasionally the membership.

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- Regulators – The regulators already perform their own analysis and testing for interest rate risk and liquidity risk as part of their examination process. This typically includes a review of the credit union’s asset/liability management (ALM) policy and ALM analysis. Additionally, the regulators typically perform their own analysis on the interest rate risk and liquidity risk to measure exposure to the insurance fund.
- Creditors – Most credit unions have a line of credit and/or other borrowing arrangements to facilitate their liquidity needs. Having interest rate and liquidity risk disclosures could be helpful to these users of the financial statements; however, as noted in the CUNA survey results, the request for this information is very rare.

So it is clear based on the survey results that credit union stake holders are not requesting the information that is being proposed in this ASU. However, if the FASB concludes that there is a need for this information, we believe that this information should be presented as supplemental information rather than a note disclosure in the financial statements.

Should the FASB determine that it is necessary to present this information as a note disclosure in the financial statements rather than excluding the information or making it supplemental information, we noted the following problems with the proposed ASU.

Interest Rate Risk Disclosures:

As noted in our overview, the predictive nature of this type of disclosure is inconsistent with any other type of financial information that is disclosed in a set of financial statements. This type of disclosure requires a number of assumptions and is inherently inaccurate. To present this information as a footnote in a set of financial statements will likely be misleading to the reader of the financial statements. Therefore, we believe that this information would be better presented as supplemental information.

Some specific problems we find with the interest rate risk disclosures are as follows:

Paragraph 825-10-50-23Y, and the required “Financial Institution Repricing Analysis as of December 31, 20x1” table

This appears to be the method referred to as the “GAP” method in the credit union industry. We believe that this method is outdated and no longer widely used within the industry; therefore, if this type of information were to be presented in the financial statements (which we do not support), it may be better to use a more contemporary method to present this information.

From an audit perspective, since this information is subjective due to the varying maturities and prepayment speeds among a number of the instruments in the balance sheet, providing an opinion attesting to the accuracy of the information if it is presented as a footnote could be misleading to the reader of the financial statements. Therefore, due to the subjective nature of the information and the

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proposed presentation methods, we feel this information would be better placed in the financial statements as supplemental information.

Paragraph 825-10-50-23AD, and the “Interest Rate Sensitivity” table,

This table presents the effects of the specified hypothetical instantaneous interest rate changes as of the measurement date. Instantaneous rate shifts do not happen in the market place. This is a useful management tool to perform “what if” analysis to understand the general impact of changes in market interest rates; however, this is misleading information to the financial statement user if it is presented as footnote information versus a supplemental disclosure.

This paragraph of the ASU further requires that the effects of the specified hypothetical instantaneous interest rate changes as of the measurement date to net income and stockholder’s equity (members’ equity in the case of a credit union) be reported in the table based on certain factors as stated in the ASU. However, this is not something that lends itself to audit due to the subjective nature of many of the assumptions underlying the analysis. Again, it is our opinion that this information would be better presented as supplemental information, if it is presented at all.

Liquidity Risk Disclosures:

In general, we believe that the information is readily available to prepare the disclosures for this section of the proposed ASU. However, we have concerns with certain portions of this disclosure which are provided below:

Paragraph 825-10-50-23S, and the required “Available Liquid Funds” table

We believe that clarification is needed regarding the definition of “high-quality” liquid funds. Typically, defining high quality liquid funds is a function of the maturity of an asset; however, in this paragraph the FASB has seemingly defined highly liquid as the ability to liquidate an asset through a readily available secondary market. This definition presents this information in more of a worst case or emergency situation as typically assets liquidated in this manner would be at fire sale prices and only done in an emergency situation. It is our opinion that this information would be more relevant if it was presented in a format that reflects management’s normal operating cash needs. This is typically analyzed by comparing the liquid assets (90 days or less maturity) to the projected cash outflows of the financial institution.

Paragraph 825-10-50-23E, and the required “Liquidity Gap Maturity of a Financial Institution’s Instruments” table

We noted the following:

- The ASU requires the use of “expected maturities,” however, expected maturities will vary based on the changes in the interest rate environment. For example, in a declining interest rate

market, a callable debt security will have a shorter expected maturity versus in a rising interest rate market.

- The ASU does not provide guidance on the assumptions to be applied to non-maturity deposits. This is an extremely important assumption to the analysis and, without guidance from the FASB, would lead to inconsistent approaches to this disclosure.

We believe there will be inconsistency in applying the above requirements; as a result, the disclosure will not be comparable between financial institutions.

Paragraph 825-10-50-23G, and the required “Liquidity Gap Maturity of a Financial Institution’s Instruments” table

We do not believe the requirement for quarterly information is necessary to present this information to the financial statement user. We believe that annual information would be sufficient to the reader.

Paragraph 825-10-50-23S, and the required “Available Liquid Funds” table

We believe that the information required in this paragraph and the related table is already required in the codification. As a result, we believe that this requirement is not necessary.

Paragraph 825-10-50-23L, and the required “Time Deposits Issued for the 12 Months Ended December 31, 20X1, Period of Issuance for the Last 12 Months” table

We believe that the information required by this paragraph does not enhance the usefulness of the financial statements to the user.

General Observations About Examples Provided

We find a pervasive problem with the ASU. We note that in many instances, the illustrations do not clarify the requirements in the text, but actually make the requirements confusing. In many instances, the examples include extemporaneous information that is not required in the actual text of the ASU.

The following illustrates where the examples include information that is not clearly required in the text of the Standard:

- Example 4 includes other assets, total assets, other liabilities, equity, total liabilities and shareholder equity, excess/deficit of the financial assets over financial liabilities, financial assets to financial liabilities and cumulative financial assets over financial liabilities.
- Example 4 includes other assets, total assets, other liabilities, equity, excess/deficit of the financial assets over financial liabilities, financial assets to financial liabilities and cumulative financial assets over financial liabilities.
- Example 7 includes information provided by parent and subsidiary, however, this breakout is not required within the text.

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- Example 9 includes other assets, total assets, other liabilities, equity, total liabilities and shareholder equity, excess (/deficit)^[1] of the financial assets over financial liabilities, financial assets to financial liabilities and cumulative financial assets over financial liabilities.
- Example 11 includes the table of "Hypothetical Yield Curves."

We suggest that the examples only include the required information necessary to meet the objectives of the ASU.

We appreciate the opportunity to provide our thoughts on the proposed ASU and hope that the FASB carefully considers the cost of presenting these disclosures in the financial statements of non-public entities versus the benefits derived from the additional costs. If you have any questions regarding our comment letter on proposed ASU 2012-200, Interest Rate Risk and Liquidity Risk Disclosures, please contact John Murnane.

Sincerely,

Orth, Chakler, Murnane & Company

Orth, Chakler, Murnane & Company
Certified Public Accountants

^[1] The language is different as compared to Example 4, above.