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LETTER OF COMMENT NO.



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SFAS 115 was a significant evolutionary improvement in financial reporting when it was issued in 1993. The major part of the evolutionary aspect of SFAS 115 was the use of OCI as the place for the unrealized holding gains and losses for available-for-sale securities to be recorded (outside earnings). Another part of the evolutionary aspect was that when a holding gain or loss was realized, the realized gain or loss would be reported in earnings and removed from OCI (this is called recycling) Allowing recycling has the benefit of having holding gains and losses ultimately affect earnings. The negative is that the recycling reports the gains and losses that occurred in prior reporting periods to be reported in the current reporting period—an earnings management facilitator.

As a means of damping the earnings management aspect of recycling, SFAS 115 requires that Other Than Temporary Impairments (OTTI) of individual securities be recycled to earnings even if the loss is not realized by a disposal transaction.

The idea of OTTI recognition is fine. It does reduce the ability to manage earnings. However OTTI recognition is not neutral. Recognition of holding gains reflecting prior reporting period changes in the current reporting period is unrestrained.

As the writer of a firm's comment letter on the ED that led to SFAS 115, I agreed with the evolutionary improvement to financial reporting caused by SFAS 115 and felt "good" about the OTTI requirement. As an EITF member and FASB Board member subsequent to the issuance of SFAS 115, I was happy that the OTTI requirement continued to be used in the literature.

The problem with an OTTI requirement is that it is not operational and not neutral. The "good" feeling about having this conservative, carnings management dampener disappears when you see the inconsistency of its application over time and between entities.

As both and as EITF member and FASB Board member, I worked with others, including the financial institution regulators and the SEC, to try to create guidance to make OTTI operational. These efforts included one-on-one meeting with the regulators and SEC and

drafting of EDs. The reasons these efforts to provide guidance failed is that OTTI requires both a determination of what an entity's actions will be in the future and a determination of how a securities fair value (exit price) will change in the future. Preparers and Auditors cannot predict the future. The financial statements User receives information that is subject to Preparer, Auditor and SEC staff bias. The bias in applying OTTI are constantly changing and thus the information provided by OTTI is of little value.

One of the reasons for the current ED is the calls by the SEC staff and others to use consistent impairment guidance throughout GAAP—especially for financial assets. The ED does the opposite. It introduces a second type of impairment recognition for credit concerns (incurred losses for debt instrument assets that are not securities and a type of expected loss for debt instruments that are securities) and a second type of OCI. The "Subsequent Measurement" guidance in the ED sounds "good" but I don't know what the financial statement User will do with the resulting information and it would appear to add significant complexity to the accounting.

If the FASB seeks to issue guidance based on the ED, I believe they will be required to expand on its complexity by answers questions like:

What will be the tainting rules if the Preparer's assertions about holding the asset prove to be contradicted by sales?

What is the accounting if the assertions change?

Isn't the information needed to apply the guidance the information that a number of financial institutions who commented on in response to the first 107 FSP ED said was not available.

Finally, will the PCAOB and ASB be asked to provide more auditing guidance to audit current and future Preparer's intentions and future exit prices?

## Overall Comment

Although I do not agree that the proposed guidance on making fair value estimates in inactive markets will solve the concerns sited in the Alternative View, I do agree with the other parts of the Alternative View.

Also, I believe that the idea of OTTI should be replaced with more comprehensive guidance on accounting for all financial instruments held as assets. But until that is done, modifying OTTI guidance as proposed in this ED will add confusion, not improve the financial statement. User's confidence in the financial reporting will not improve. It will be hard to create the needed improved comprehensive guidance.

If the majority of the FASB Board believes for political reasons that they must issue something on OTTI at this time, I would like to meet with the Board and staff to propose an approach that would change the accounting for OTTI that would move towards a more

comprehensive solution. Please contact me at 203-358-8274 or email at HYPERLINK "mailto:ewtrott@aol.com" <a href="mailto:ewtrott@aol.com" ewtrott@aol.com" ewtrott@aol.com" ewtrott@aol.com</a>.