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LETTER OF COMMENT NO. 249

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LETTER OF COMMENT NO. 288

File Reference: Proposed FSP's FAS 157-e and FAS 115-a, FAS 124-a, and EITF 99-20-b

Dear Mr. Golden:

The Center for Audit Quality ("CAQ")¹ is pleased to have the opportunity to comment on proposed FASB Staff Positions No. FAS 115-a, FAS 124-a, and EITF 99-20-b, "Recognition and Presentation of Other-Than-Temporary Impairments" ("FSP FAS 115-a") and FAS 157-e, "Determining Whether a Market is Not Active and a Transaction is Not Distressed" ("FSP FAS 157-e", collectively, the "proposed FSPs").

The CAQ supports the FASB's efforts in responding to the current economic crisis which has highlighted the difficulty in estimating the fair value of illiquid assets. It is critical that any improvements made to financial reporting address the issues at hand by enhancing the relevance and transparency of financial information that is critical to properly functioning capital markets. For this reason, we recommend that the FASB not proceed with proposed FSP FAS 157-e, but proceed with FSP FAS 115-a. We believe proposed FSP FAS 115-a (appropriately modified) will achieve the objectives of providing preparers appropriate relief from the impact of fair value measurements in the current market environment without significantly

¹ The CAQ is an autonomous, nonpartisan, nonprofit group based in Washington, D.C. It is governed by a Board that comprises leaders from the public company auditing firms, the American Institute of CPAs and the investor and issuer communities. The CAQ was created to serve investors, public company auditors, and the markets by fostering confidence in the audit process and by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. The CAQ is affiliated with the American Institute of CPAs.

reducing the transparency that investors and other users of financial statements seek. We do not believe that is true with respect to the proposed FSP 157-e. The proposed FSP 157-e, which proposes an exception to the definition of fair value, would reduce the transparency that investors seek and, as explained further below, would have significant unintended consequences. If the Board decides to go forward with FSP 157-e, we believe that at a minimum, significant revisions should be made to the proposed FSP as discussed below. Furthermore, we do not believe that the proposed FSP 157-e mitigates the need for proposed FSP FAS 115-a.

Regardless of how the FASB proceeds with the current FSP proposals, we would like to stress the importance of an independent, unbiased standard setter for accounting standards. The CAQ firmly believes that an independent standard setter is fundamental to investor confidence and is a key underpinning of high quality financial reporting standards. The current economic crisis increases the urgent need for accounting guidance; however, appropriate due process and independence are vitally important to maintaining confidence in, and the relevance, usefulness, and transparency of, financial information. Just as critical, accounting standards should be promulgated to promote financial transparency and address investor information needs.

On the other hand, prudential regulators, such as those who regulate and set capital standards for banks, have the ability to obtain information outside of the financial statements and to make changes or adjustments to such standards and requirements for bank capital purposes as they deem necessary and appropriate without having to make changes to the fundamental accounting determinations and resulting investor information.

FSP FAS 157-e, Determining Whether a Market is Not Active and a Transaction is Not Distressed

As stated in recent congressional testimony, the CAQ acknowledges that further clarification on when a market is not active and a transaction is distressed is necessary. However, we believe that the proposed model of establishing a (rebuttable) presumption that all transactions in inactive markets are distressed is flawed. This concept forces preparers to ignore relevant market transactions and moves away from the exit price objective which is the cornerstone of measuring the fair value of an asset. By ignoring relevant market transactions and moving to models in such a wholesale manner, transparency will suffer and the measurement results will no longer represent “fair value” as defined by Statement 157².

In addition, the departure from an exit price in the current market that is proposed in FSP FAS 157-e, is very broad and may have significant unintended consequences, including the potential increase in day one gains, delay of losses recorded on debt securities which the holder intends to sell, and inflating net asset values used by investment companies for transactional purposes, to name a few.

² FASB Statement No. 157, *Fair Value Measurements*



If the Board decides to go forward with FSP FAS 157-e, significant revisions are required. The Board should consider limiting the scope to certain illiquid debt securities which seem to be the focus of undertaking the project. In addition, as the measurement attribute in the proposed FSP for financial assets in inactive markets departs from an exit price, we believe terminology other than “fair value” should be used. It would then follow that, because the measure under the proposed FSP would not be considered fair value, entities should be reminded of the existing requirements in Statement 107³ to disclose fair value for such instruments. Additionally, Statement 157 should be amended to require disclosures similar to those required by paragraph 32 for the new measurement attribute.

Furthermore, the CAQ believes that the proposed FSP should include additional implementation guidance to support the new measurement principle used in the proposed FSP, including a clear articulation by the FASB regarding the objective of this new measurement. Without appropriate application guidance, the proposed FSP will be operationally difficult to implement and will effectively “shrink” what are considered to be active markets and expand what are considered to be inactive markets resulting in less objective measurements. This may also result in entities not willing to sell financial assets because they may realize a loss, as it will be more beneficial to carry assets at the higher “mark-to-model” value. The Board also should consider how the sale of securities under the U.S. Treasury’s asset purchase program will affect the measurement for securities under the proposed FSP.

Additionally, many entities with significant holdings of illiquid securities rely heavily on information from pricing services and brokers to determine the fair values of those securities. Because pricing information from those sources is based on observed transaction prices, the proposed FSP may preclude entities from using those traditional sources of pricing information. As a consequence, many entities might need to devote substantial cost and effort to develop alternative valuation techniques to apply the guidance in the proposed FSP.

Further, given the additional cost and operational burden presented by the proposed FSP, we believe that some preparers of financial statements will not be able to implement this FSP by the proposed effective date.

FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*

While the CAQ supports the issuance of FSP FAS 115-a, we believe that there are certain enhancements and clarifications that can be made to the proposal in order to further improve financial reporting. First, the application of the guidance and its interaction with related guidance (e.g., SEC SAB Topic 59) is unclear, particularly for equity securities. For example, does the

³ FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*

change in focus with respect to management's intent to sell (i.e., change in requirement from having the intent and ability to hold an equity security until recovery in order to not recognize an impairment as other-than-temporary) affect the determination of the period to estimated recovery for an investment?

Additionally, while the proposed FSP indicates that there are other aspects in other guidance to be considered in determining whether a security is other-than-temporarily impaired, such as the severity and duration of the impairment in SEC SAB Topic 59, it is confusing to have the guidance on other-than-temporary impairments in several places. Accordingly, we recommend that the guidance in the proposed FSP be combined with related existing requirements into one final standard, and the interaction of the new guidance with existing principles should be illustrated.

Further, we are concerned that the term "credit losses" is confusing and may result in inconsistent application. We encourage the Board to consider requiring an incurred loss approach for measuring credit impairment on held-to-maturity (HTM) and available-for-sale (AFS) securities similar to the impairment model for loans under Statement 114⁴. Under this approach, the final standard would specify that the credit impairment to be recognized in earnings would be the difference between the security's amortized cost and the present value of expected future cash flows discounted at the debt security's effective interest rate.

We do not support the proposed requirement that, for held-to-maturity securities, the difference between the security's fair value and the security's amortized cost less the credit impairment recorded in earnings is recognized in other comprehensive income upon recognition of the other-than-temporary impairment and subsequently amortized through other comprehensive income. We do not believe that recognition in other comprehensive income serves a valid purpose for a security that will be held to maturity.

We recognize that some entities may have difficulties implementing the proposed FSP by the proposed effective date. The CAQ encourages the Board to either (a) extend the effective date to interim and annual periods ending after June 15, 2009 with early adoption permitted, or (b) hold discussions with the SEC regarding whether an extension of the quarterly filing deadline for the quarterly period ending after March 15, 2009 would be appropriate.

In summary, we believe the proposed FSP FAS 157-e as currently proposed is not in the best interest of the public, whereas the proposed FSP FAS 115-a is meritorious but warrants modification prior to finalization. Therefore, we recommend that the FASB not proceed with proposed FSP FAS 157-e, but proceed with FSP FAS 115-a (appropriately modified).

⁴ FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*



The CAQ thanks the FASB for the opportunity to comment on the proposed FSPs, and we would be pleased to discuss our comments with you or the staff at your convenience. Many of the public company auditing firms that are members of the CAQ will also submit their own comment letters.

Very truly yours,



Cynthia M. Fornelli
Executive Director
Center for Audit Quality

cc:

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