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Mr. Russell Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

File Reference:

No. 1810-100 Accounting for Financial Instruments and Revisions to the

Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden,

Thank you for the opportunity to comment on the proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities. By way of background, J.D. Cloud & Co. L.L.P. is the oldest independent public accounting firm in Cincinnati, Ohio. We are a PCAOB registered firm and over the years, we have served a variety of clients in a variety of industries. One of our significant niche practice areas and long-standing client cluster groups is the financial services industry which is comprised principally of community banks and savings and loan associations.

The proposed standard makes several very significant changes to existing accounting guidance which appears to not only cause confusion to the users of the financial statements, but would also be costly and difficult to objectively implement. The following highlights some of our more significant areas of concern.

#### Loan Valuation

The proposed standard requires loan portfolios to be carried at fair value on the balance sheet and marked to market each reporting period, with changes reported in other comprehensive income or the income statement depending upon the entity's business strategy to trade or hold the portfolio for collection. Loan portfolios held for contractual maturity are typically an integral component of the revenue generating assets of a financial institution. Currently a loan, unless specifically identified for sale, is held by an entity for the primary business objective of collection of interest and any related fees over the life of the instrument. The primary objective is certainly not to realize a financial reward from the short or immediate term liquidation of the asset. Therefore, carrying such an asset at anything other than the amortized cost (adjusted for any impairment for uncertainty with respect to its probable ultimate collectability) would be a theoretically irrelevant measurement and incongruent with the entity's business strategy.

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If the loans were to be carried at fair value, another issue arises. Valuation of individual loans or a loan portfolio is a very subjective process and involves a number of assumptions to quantify the current market value of what is typically a unique portfolio. Also, as has been evidenced in the past few years, valuation quantification is exacerbated by the extreme volatility in the economic markets. In addition, if an institution wished to affect the value of its loan portfolio and reported comprehensive income, seemingly insignificant variations in assumptions may cause significant variations in the computed market value. Considering the cost to value a loan portfolio, coupled with the cost to adequately audit these values, we believe the overall cost of compliance with this standard would be an excessive financial burden. Recording the estimated fair value of the portfolio on the face of the balance sheet would also, in all likelihood, portray to the user a certainty as to the fair value of a portfolio, but that may have no relevance for most community financial institutions. Currently FASB ASC 825-10-50 requires such information to be disclosed in the footnotes of non-public institutions over \$100 million in asset size. However, based on discussions with management, boards of directors and shareholders, even this required disclosure is usually of limited use to the users of a community financial institution's financial statements.

### **Asset Impairment**

Under the proposed standard, impairment on a financial asset would be recognized based on an assessment at each reporting date of cash flows expected to be to be collected compared with the contractual amounts due, instead of waiting to recognize the impairment loss until the credit loss is deemed probable under existing guidance. The quantification of this expected loss would be virtual guesswork for most community financial institutions and would be subject to second guessing by the auditors and regulatory examiners. The extreme imprecise judgment required to comply with this portion of the proposal would create confusion and would require predictive exercises that may not result in information about the true current credit quality of the existing asset portfolio. In any event the credit impairment model being developed by the IASB should be the forum for the ultimate deliberation and conclusions reached regarding accounting for credit impairment.

## **Core Deposit Liabilities Valuation**

Similar to issues regarding the proposed loan valuation, assigning a value to core deposit liabilities using the specific proposed guidance and creating an internally-developed intangible asset that is periodically revalued has no relevant meaning to financial statement users and is laden with even more subjective assumptions. Core deposits typically are an integral part of the overall business strategy for the preponderance of community financial institutions. Deposits are typically not bought or sold and depositors are viewed as long-term relationships that provide asset funding sources for financial institutions. Continuing to carry deposits at the existing historical value should be consistent with loans.

#### **Comprehensive Income**

Another consequence of this proposed standard involves the interpretation of comprehensive income. The proposed disclosure enhancement to comprehensive income (i.e. requiring disclosure on the face of the income statement) appears to be indicative of the Board's initiative to place more emphasis on this financial statement line item. If a change in fair value measurement of loans, along with a variety of other adjustments to other comprehensive income as proposed in this standard, is reflected in other comprehensive income the basic definition of

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this caption becomes vague and obscure as more adjustments are reflected in this category. Other comprehensive income, and thus comprehensive income, appears to be developing into a collection of disjointed, arbitrary adjustments that result in total confusion for the average financial statement user.

# **IFRS** Convergence

Notwithstanding the specific areas of concern mentioned above, this proposed standard obviously conflicts with International Financial Reporting Standards ("IFRS") No. 9 which essentially allows for financial instruments to be carried at amortized cost or historical cost based on the entity's business strategy to hold to maturity. Why the FASB would chose to deviate from the convergence initiatives underway, is a mystery in itself.

## **Unintended Economic Consequences**

The proposed standard, as designed, will inevitably have unpredictable unintended behavioral consequences. These could include entities beginning to focus on investing in assets not subject to volatile valuation techniques and other unforeseen changes that could possibly alter the landscape of the public financial markets. These uncertainties created by comprehensive adoption of the proposed standard are unpredictable at this stage, but should not be overlooked.

Once again, thank you for the opportunity to respond and we encourage the Board to consider revising the proposed standard.

Sincerely.

J.D. CLOUD & CO. L.L.P.

Craig M. Johnson, CPA

Partner