

FASB

File Reference
No. 2013-220

Ap013

I do not support the ED's proposed mixed attribute measurement of financial assets. The use of Business Model or Intent to determine a measurement to faithfully represent financial assets is suboptimal. Labeling and display to identify how a financial asset is currently intended to be recovered is the appropriate way to communicate that information. Business entities continually modify their intent as economic risks and opportunities change. Intent is not stable enough to base a measurement decision when alternatives are available.

Both amortized cost (with an appropriate definition) and fair value measurements provide useful financial information. However, the ultimate measurement for financial assets should be fair value.

I have provided my views about the accounting for financial assets (and their impairment) to the FASB in comment letters and in other ways. However, I am convinced that the current Board believes their standard-setting efforts must produce "popular" standards that do not cause major changes to current practices rather than accepting more change for higher quality standards. This is evident when you read the Basis for Conclusions in the Statements they have issued and in their practice of issuing multiple EDs in the same project. Therefore, this comment letter will focus on other parts of the ED.

Definition of Cost and Amortized Cost

The definition of cost for a financial asset should be the asset's fair value at initial recognition. That measurement best represents the value of the asset's future cash flow at that time. Including transaction cost (or net loan origination cost as discussed in 825-10-30-2) as proposed in the ED's definition of Amortized Cost incorporates past cash flows into an amount that should represent the value of future cash flows. If two identical financial assets are acquired or originated at the same time but have different transaction costs, the identical assets will appear on the balance sheet at different amounts. The one

with the higher transaction cost (past cash flow) will be represented at a higher amount. A higher amount on a balance sheet usually is interpreted as a higher valued asset. The ED's accounting is counterintuitive!

Transaction cost (or net loan origination cost) mechanically adjusts the asset's discount rate (or yield rate) to enable the ED's definition of cost to equal a present value of the assets future cash flows. The asset's discount rate (or yield rate) should only reflect the risk related to the future cash flows. Why should a past cash flow distort the reporting of ownership of a financial asset in future periods? This accounting should be discussed in the Basis of Conclusion and the rationale explained. Using a justification such as "the matching principle" or an "income statement perspective"(they are not in the FASB's Conceptual Framework) are not valid arguments! A financial asset's transaction cost do not meet the definition of an asset and should not be treated as if they do. Also, the bookkeeping for the acquisition of a financial asset using the asset's fair value as its cost will appropriately deal with any premium or discount that should be reflected in the asset's yield rate.

Excluding transaction cost and net loan origination cost from a financial asset's cost will simplify accounting and record keeping. Many uneconomic schemes were developed to take advantage of Statement 91's accounting provisions. I expect a close look at current accounting practices in this area would reveal many problems. It is not clear whether the provisions on loan origination costs apply to other transaction costs.

Another element in the ED's definition of Amortized Cost that should be excluded is the increase or decrease in the asset's fair value attributable to the hedged risk in a fair value hedge. Combining cost with fair value into one number produces a mess! What is it? The combination makes cost lose its value as a representation of contractual cash flows. Until hedge accounting is addressed, I suggest the change in an asset's fair value attributable to a hedged fair value risk be presented as a separate amount on the balance sheet like the allowance for credit losses.

Initial Measurement

In concert with the discussion above, the initial measurement for all financial assets should be the asset's fair value at initial recognition. It should not matter how the asset is subsequently measured. Thus, paragraphs 825-10-30-1 to 3 can be simplified.

Also, the identification of “Something Other” would be simplified if the initial measurement was fair value. The attempt in paragraphs 825-10-30-5 and 6 and BC 153-156 to make the need to look for “Something Other” ambiguous will only produce practice problems. An argument that I don’t know how to determine a financial asset’s fair value at the time an asset is initially recognized does not hold water! Why is it harder when initially recognized than at the end of a reporting period when it is required? If the transaction price includes a marketing incentive, that incentive should be expensed like other marketing items.

Income Management

The Basis of Conclusions of Statement 115 (on which much of the ED is based) notes that it did not deal with the major problem of what we today call “Income Management.” The ED does not solve this problem but expands it. I suggest the following to help financial Statement Users identify income management:

- The change in fair value reported in OCI as of the beginning of the period in which a financial asset with the change in fair value reported in OCI is sold should be transferred to Retained Earning and not reported in the determination of a period’s net income. The disclosure proposed in paragraph 825-10-50-37 is not adequate.
- For assets carried at amortized cost, the unrealized gain or loss based on fair value as of the beginning of the period in which the asset is sold should be disclosed. The disclosure in paragraph 825-10-50-35 is not adequate.

Don’t Eliminate the FV Option for Equity Method Investments

The amount produced by applying the equity method is the result of a calculation. The amount does not provide useful information and many times will not be representationally faithful of the asset it represents. A fair value measurement of an equity method investment does provide information that can be understood. It is representationally faithful. Although, I would prefer that the equity method be eliminated, I at least encourage the Board not to eliminate the FV option for this asset. The use of fair value to account for these assets would reduce accounting and auditing complexity.

Other Items

I agree with the comment letter from Financial Reporting Advisors, LLC with respect to evaluating the need for a valuation allowance on deferred tax assets related to unrealized losses in OCI.

The discussion in BC 158 on “Transaction Costs and Fees,” the guidance in 825-10-30-1, and the definitions of amortized cost and transaction cost in the ED’s Glossary are not consistent.

A definition of “Transaction Price” is needed.

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Contact me at ewtrott@gmail.com if you would like to discuss these comments.

Sincerely,

Edward W. Trott