



May 21, 2013

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

File Reference No. 2012-260

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update “Financial Instruments – Credit Losses (Subtopic 825-15)”. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

Our Committee is supportive of the Board’s efforts to work with the International Accounting Standards Board to simplify and converge accounting guidance. We appreciate the thought and effort that have gone into projects such as revenue recognition and leasing in particular because comprehensive standards help to eliminate the need to rely on industry or regulatory guidance. We see a potential benefit of this project is the elimination of a need to consult such sources for guidance on non-accrual status or the accounting for write-offs and recoveries.

After much discussion, however, this Committee has come to the conclusion that it cannot support the issuance of this Proposed ASU as it has been constructed because:

- It results in financial reporting that is inconsistent with established principles of accounting theory and the Conceptual Framework;
- It expands the opportunities for manipulation of financial reporting; and
- It is unduly influenced by the goals of prudential regulators, which are not necessarily consistent with unbiased financial reporting.

We believe the fundamental premise on which the Proposed ASU rests is at odds with the Conceptual Framework. The Proposed ASU requires the recognition of ‘day one’ losses for ‘at-market’ loans and then anticipates losses over the lifetime of a loan. At the inception of a loan, a bank considers the probability of default and prices this into the interest rate and other terms of the loan such that the initial ‘cost’ of the loan is generally equal to its fair value. By requiring banks to recognize a provision for current expected credit losses for at-market loans at inception the Proposed ASU would require banks to recognize expected credit losses twice – once through the initial pricing of the loan and again through the separate ‘day one’ loss allowance. This results in financial statements that do not faithfully represent the economic phenomenon of the issuance of an at-market loan, whereby neither party has realized an economic gain or loss. In addition, the Proposed ASU results in financial reporting that is not neutral or unbiased over the life of a loan; future credit losses are anticipated, but future economic gains (i.e., interest income) are not. On the other hand when considering ordinary trade accounts receivable, we have previously agreed with the Board’s proposed model for accounting for customer credit risk by means of a “day 1 loss” in the form of the allowance for doubtful accounts and associated bad debt expense. Pricing on these sales transactions is not the same as pricing on loans, hence we see no inconsistency in differing forms of presentation.

The Proposed ASU appears to add additional complexity to fair value accounting and presentation with respect to financial instruments carried at fair value adjusted through Other Comprehensive Income. The exposure draft offers a “practical expedient” to the reporting entity by allowing it to ignore credit loss so long as the fair value is in excess of historical cost. This implies there is additional credit impairment possible for an instrument currently recorded at fair value. It seems highly likely that an instrument’s current exit price may not fully encompass expected credit losses due to differences in reasonable and supportable forecasts between holders of instruments and those in the market who may purchase those instruments. The possibility that an economic downturn ten years from now would impact the future cash flows of an instrument may not be of concern to a potential buyer. The only reason for such an exception is that lifetime losses are not currently impounded in the fair value. This seems to be at odds with the fundamental concept surrounding fair value accounting that was the subject of so much debate in 2004: the use of exit prices to measure fair value. We are skeptical that management will avail itself of this exception. The ability to have a credit allowance applied to instruments that are purportedly at fair value is troubling conceptually and one more place for a reporting entity to establish a cushion.

This is not the only way the Proposed ASU provides management with increased ability to smooth earnings. For example, during prosperous times, banks may be incentivized to project that tough times are ahead so allowances for future credit losses are increased; during downturns banks may be incentivized to project that the economic environment will improve and allowances for future credit losses can be reduced. We believe that it will be increasingly difficult to prevent such financial reporting manipulation because forecasts of future economic activity are particularly uncertain, and a wide range of forecasts ranging from strongly ‘bullish’ to strongly ‘bearish’ is typically present in the marketplace. Supporting a ‘bullish’ or ‘bearish’ forecast is no more than deciding with which pool of Nobel Prize winning economists to agree. We do not support an increase in the sorts of “cookie jar reserves” openly condemned by Arthur Levitt nearly fifteen years ago.

By migrating to a model in which the goal is to anticipate future losses and recognize them currently, we believe the Board is caving in to pressure from regulators and the political sector to achieve a model whereby banking reserves are increased. Many believe the FASB broke off its convergence efforts with the IASB in large part due to intense pressure from US banking regulators who were concerned that the joint model would result in reserves that were ‘too small.’ While we certainly appreciate the pressure the Board has been under both from regulators and from the political forces that drive those regulators, we believe financial accounting standards should continue to be based on accounting theory, and not the objectives of prudential regulators, who have different goals and objectives, including political ones. There are economic downturns and companies do lose money; some go out of business. The fact that those downturns are rarely anticipated is a fact of life; trying to ease the pain by promulgating an accounting standard that essentially mandates income smoothing by accelerating future losses into current periods is a retreat in the face of pressure to “do something” to prevent future surprises. We do not believe it should be the goal of the Proposed ASU to prevent such surprises.

We have also followed the IASB’s project and have similar objections. Financial reporting must rest on a sound conceptual framework. To the extent that U.S. or international banking regulators have issues with the manner in which allowances for loans or asset-backed securities are determined, we believe those regulators should address those concerns by the manner in which they set minimum capital requirements and not pass the baton to the FASB or IASB to write accounting standards whose objectives are to meet regulatory objectives. We encourage both boards to work together to achieve standards consistent with their conceptual frameworks rather than compete to gain approval of their accounting models from governmental and regulatory bodies.

In that vein, we encourage the Board to return to its efforts on the Conceptual Framework including projects on measurement and recognition. We believe re-focusing on the framework would provide clarity to the Board’s efforts to work through these more difficult projects and assist the Board in responding to the concerns of primary users, regulators and other interested parties. The determination that credit impairment is a measurement issue rather than a recognition issue is the fundamental determination that has driven this project. Recognizing future

losses rather than incurred losses is a change in the principles underlying the Conceptual Framework that will force the Board to reconsider accounting for everything from business combinations to litigation contingencies.

We appreciate the opportunity to offer our comments.

Sincerely,

**Scott G. Lehman, CPA**

Chair, Accounting Principles Committee

**Amanda M. Rzepka, CPA**

Vice-chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE  
ORGANIZATION AND OPERATING PROCEDURES  
2013-2014

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

**Public Accounting Firms:**

**Large:** (national & regional)

Ryan Brady, CPA	Grant Thornton LLP
Todd Briggs, CPA	McGladrey LLP
Brian Chmiel, CPA	Crowe Horwath LLP
Frank Dery, CPA	PricewaterhouseCoopers LLP
John Hepp, CPA	Grant Thornton LLP
David Jamiolkowski, CPA	Baker Tilly Virchow Krause, LLP
Scott Lehman, CPA (Chair)	Crowe Horwath LLP
Elizabeth Prossnitz, CPA	BDO USA LLP
Robert Sledge, CPA	KPMG LLP

**Medium:** (more than 40 professionals)

Timothy Bellazzini, CPA	Sikich LLP
Christopher Cameron, CPA	Kutchins Robbins & Diamond Ltd
Michael Kidd, CPA	Mowery & Schoenfeld LLC
Gary Mills, CPA	Frost Ruttenberg & Rothblatt PC
Tad Render, CPA	Miller Cooper & Company Ltd
Steven Roiland, CPA	Kessler Orlean Silver & Co., PC
Jeffery Watson, CPA	Miller Cooper & Company Ltd

**Small:** (less than 40 professionals)

Peggy Brady, CPA	Selden Fox, Ltd.
Brian Kot, CPA	Cray Kaiser Ltd CPAs

**Industry:**

Rose Cammarata, CPA	CME Group Inc.
Farah Hollenbeck, CPA	Abbott Laboratories
Joshua Lance, CPA	N Pritzker Capital Management LLC
Marianne Lorenz, CPA	AGL Resources Inc.
Michael Maffei, CPA	GATX Corporation
Anthony Peters, CPA	McDonald's Corporation
Amanda Rzepka, CPA (Vice Chair)	Jet Support Services, Inc.
Richard Tarapchak, CPA	Navistar International Corporation

**Educators:**

Martin Coe, CPA	Western Illinois University
James Fuehrmeyer, Jr., CPA	University of Notre Dame

**Staff Representative:**

Gayle Floresca, CPA	Illinois CPA Society
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