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Technical Director
Financial Accounting Standards Board
401 Merritt 7
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File Reference No. 2012-260- *Proposed Accounting Standards Update, Financial Instruments – Credit Losses (Subtopic 825-15)*

CliftonLarsonAllen LLP appreciates the opportunity to comment on the Proposed Accounting Standards Update (ASU), “Financial Instruments-Credit Losses.”

We believe the current expected credit loss model (CECL) is not operational and will not effectively address the shortcomings of the incurred loss model identified in the exposure draft. We believe the CECL model will be unworkable and a burden for community banks and credit unions to implement and, as such, will not give financial statement users the comparable and reliable information they seek. While we understand that some changes need to occur with the incurred loss model currently employed, we believe:

1. The proposed CECL model will be more complex to develop and maintain for community banks and credit unions with limited benefit to financial statement users.
2. FASB should consider modification of the current “probable” threshold in an effort to reduce the delayed recognition issues associated with the incurred loss model.
3. FASB should consider utilizing a limited time horizon for expected loss forecasts to promote consistency and align the expected loss forecast period to a timeframe that will yield more accurate, reliable and comparable results.

Sincerely,

Jerry Felicelli
Financial Institutions Partner-in-Charge
CliftonLarsonAllen LLP

CECL model complexity with limited benefit to financial statement users

We are not confident that, if an expected loss model were in place at the onset of the most recent financial crisis, financial statement users would have been provided with an accurate representation of uncollectible cash flows as the industry underestimated the extent and duration of future losses at that time. Thus, we do not believe the proposed expected loss model will provide financial statement users with the desired information at the onset of future periods of significant credit deterioration.

At the onset of the recent financial crisis, community banks and credit unions were widely criticized for not supporting or updating, in a timely manner, qualitative factors utilized in their incurred loss models which prompted regulators to encourage the shortening of the aggregate historical loss period used as the basis for allowance calculations in an effort to compensate for perceived inadequate reserves. If institutions weren't capable of adequately updating or supporting sufficient qualitative factors, intended to adjust historical loss experience to the current environment, we anticipate that management of community banks and credit unions will struggle with the more difficult task of adequately forecasting and supporting their forecasting of expected losses for future periods. Thus, we believe the expected loss model will slightly reduce, but not effectively correct, the problem of delayed loss recognition.

It took many years for most community banks and credit unions to develop a well documented incurred loss model that is operational and functional. The limited resources available to these institutions could mean it will take several years to obtain sufficient details to identify trends in loss cycles for each loan type sufficient to provide the required historical loss data to serve as a basis for preparing reasonable and supportable future forecasts. Similar to our experience with the incurred loss model, we anticipate it will take several years of post-implementation experience with an expected loss model for community banks and credit unions to achieve the results and directional consistency financial statement users should expect. Why incur this degree of time and expense to develop and maintain a model that we expect will yield only marginally better results?

Modification of the current “probable” threshold

We believe lowering the threshold of when credit losses should be recognized from “probable” to an alternative, such as “more likely than not” is an acceptable modification to the incurred loss model to address the issue of delayed recognition. We appreciate that an alternative threshold would require more guidance but we believe it would achieve the desired results for financial statement users in a cost effective manner for community banks and credit unions.

Limited time horizon for expected loss forecasts

This compromise between the current incurred loss model and the proposed CECL model would reduce the expected loss forecast estimate from the life of the asset to a timeframe that we believe could be more accurately estimated and more reasonably supported by community banks and credit unions. We believe community banks and credit unions can more accurately estimate and support expected loss forecasts over a time horizon of 24 months and suggest that such a time horizon represents their “foreseeable future” which is a term that appears in existing accounting literature. This shortened timeframe will provide financial statement users with more accurate estimates, address the matter of delayed losses in a more cost effective and supportable manner for community banks and credit unions and reduce the perceived comparability issues associated with institutions utilizing different asset life estimates.

Responses to Questions in the proposed ASU

Question 1: Do you agree with the scope of financial assets that are included in this proposed Update? If not, which other financial assets do you believe should be included or excluded? Why?

Response: We agree with the scope of the financial assets in the exposure draft.

Question 9: The proposed amendments would require that an estimate of expected credit losses be based on relevant information about past events, including historical loss experience with similar assets, current conditions, and reasonable and supportable forecasts that affect the expected collectability of the financial assets' remaining contractual cash flows. Do you foresee any significant operability or auditing concerns or constraints in basing the estimate of expected credit losses on such information?

Response: If the reasonable and supportable forecasts are well supported by sufficient documentation, we believe we would be able to audit management's estimate of expected losses. However, we are concerned about the lack of observable data community banks and credit unions will be able to provide to support their forecasts of expected losses and their estimate of the current point and forecast direction of the economic cycle.

Question 10: The Board expects that many entities initially will base their estimates on historical loss data for particular types of assets and then will update that historical data to reflect current conditions and reasonable and supportable forecasts of the future. Do entities currently have access to historical conditions and reasonable and supportable forecasts of the future? If so, how would this data be utilized in implementing the proposed amendments? If not, is another form of data currently available that may allow the entity to achieve the objective of the proposed amendments until it has access to historical loss data that reflects current conditions and reasonable and supportable forecasts until such time an entity can build up its own internal loss data?

Response: While management of community banks and credit unions have the ability to gather and analyze the necessary data to support their historical loss experience for relevant loan types and can adequately support their assessment of past events, current conditions and borrower creditworthiness under the incurred loss model, the limited resources available to these institutions could mean it will take several years to obtain sufficient details to identify trends in loss cycles for each loan type sufficient to serve as a basis for preparing reasonable and supportable future forecasts. The recent financial crisis will only make this task more difficult as recent historical loss data more closely resembles a "worst case scenario" so institutions could require many more years of detailed historical data in order to establish the solid foundation required to accurately prepare reasonable and supportable forecasts of the future. Also, at the onset of the recent financial crisis, community banks and credit unions were widely criticized for not supporting or updating, in a timely manner, qualitative factors utilized in their incurred loss models which prompted regulators to encourage the shortening of the aggregate historical loss period used as the basis for allowance calculations in an effort to compensate for perceived inadequate reserves. If institutions weren't capable of adequately updating or supporting sufficient qualitative factors, intended to adjust historical loss experience to the current environment, then we anticipate that management of community banks and credit unions will struggle with the more difficult task of adequately supporting their forecast of expected losses for future periods.

Question 11: The proposed amendments would require that an estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results. This proposal would prohibit an entity from estimating expected credit losses based solely on the most likely outcome (that is the statistical mode). As described in the Implementation Guidance and Illustrations Section of Subtopic 825-15, the Board believes that many commonly used methods already implicitly satisfy this requirement. Do you foresee any significant operability or auditing concerns or constraints in

having the estimate of expected credit losses always reflect both the possibility that a credit loss results and the possibility that no credit loss results?

Response: We are concerned about the supporting documentation community banks and credit unions will utilize to reflect the possibility that a credit loss can result from certain types of instruments such as U.S. Treasuries, loans fully collateralized by certificates of deposit or loans with extremely low loan to value ratios as the possibility of loss related to such instruments is very minimal. We have similar concerns about the supporting documentation which management can provide to support their consideration that no loss can result from certain types of instruments such as higher risk loans and investments with significant credit deterioration. As expressed earlier in our comment letter, we feel confident we can audit these estimates as long as they are supported by sufficient documentation.

Question 12: The proposed amendments would require that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly. Methods implicitly reflect the time value of money by developing loss statistics on the basis of the ratio of the amortized cost amount written off because of credit loss and the amortized cost basis of the asset and by applying the loss statistic to the amortized cost balance as of the reporting date to estimate the portion of the recorded amortized cost basis that is not expected to be recovered because of credit loss. Such methods may include loss-rate methods, roll-rate methods, probability-of-default methods, and a provision matrix method using loss factors. Do you foresee any significant operability or auditing concerns or constraints with the proposal that an estimate of expected credit losses reflect the time value of money either explicitly or implicitly? If time value of money should not be contemplated, how would such an approach reconcile with the objective of the amortized cost framework?

Response: No.

Question 13: For purchased credit-impaired financial assets, the proposed amendments would require that the discount embedded in the purchase price that is attributable to expected credit losses at the date of acquisition not be recognized as interest income. Apart from this proposal, purchased credit-impaired assets would follow the same approach as non-purchased-credit-impaired assets. That is, the allowance for expected credit losses would always be based on management's current estimate of the contractual cash flows that the entity does not expect to collect. Changes in the allowance for expected credit losses (favorable or unfavorable) would be recognized immediately for both purchased credit-impaired assets and non-purchased-credit-impaired assets as bad-debt expense rather than yield. Do you foresee any significant operability or auditing concerns or constraints in determining the discount embedded in the purchase price that is attributable to credit at the date of acquisition?

Response: Community banks and credit unions typically engage a specialist to assist with determining the amount of the embedded discount and identify the related components. For those loans that have not exhibited signs of deterioration or are in the early stages of deterioration, determining the credit portion of the embedded discount is difficult and will require additional effort and expense.

Question 14: As a practical expedient, the proposed amendment would allow an entity to not recognize expected credit losses for financial assets measured at fair value with qualifying changes in fair value recognized in other comprehensive income when both (a) the fair value of the individual financial assets is greater than (or equal to) the amortized cost basis of the financial asset and (b) the expected credit losses on the individual financial asset are insignificant. Do you foresee any significant operability or auditing concerns or constraints in determining whether an entity has met the criteria to apply the practical expedient or in applying it?

Response: We believe that requiring both the fair value of the financial asset to exceed the amortized cost basis and the expected credit losses to be insignificant is unnecessarily restrictive. In our opinion, if either of these two criteria were present, the practical expedient should be available to preparers.

Question 15: The proposed amendments would require that an entity place financial assets on nonaccrual status when it is not probable that the entity will receive substantially the entire principal or substantially all of the interest. In such circumstances, the entity would be required to apply either the cost-recovery method or the cash-basis method, as described in paragraph 825-15-25-10. Do you believe that this proposal will change current practice? Do you foresee any significant operability or auditing concerns with the proposed amendment?

Response: We do not believe the proposed amendments will significantly change current practice for community banks and credit unions.

Question 18: Do you foresee any significant operability or auditing concerns or constraints in complying with the disclosure proposals in the proposed Update?

Response: We believe the disclosure requirements should be modified for nonpublic entities to take into account that financial statement users for community banks and credit unions differ from those of public entities. Additional disclosure requirements are also much more burdensome for these institutions due to the lack of robust infrastructure at community banks and credit unions.

Question 19: Do you believe that the implementation guidance and illustrative examples included in this proposed Update are sufficient? If not, what additional guidance or examples are needed?

Response: In general, we believe more guidance and illustrative examples related to investments are required.

Question 20: Do you agree with the transition provision in this proposed Update? If not, why?

Response: Yes.

Question 21: Do you agree that early adoption should not be permitted? If not, why?

Response: Yes.

Question 22: Do you believe that the effective date should be the same for a public entity as it is for a nonpublic entity? If not, why?

Response: No. We believe that the effective date for public entities should be 3 years after the final ASU is released and the effective date for nonpublic entities should be one year later than for public entities, due to the additional effort required to compile and support an accurate model.

Question 24: How much time would be needed to implement the proposed guidance? What type of system and process changes would be necessary to implement the proposed guidance?

Response: We believe that the effective date for public entities should be at least 3 years after the final ASU is released and the effective date for nonpublic entities should be one year later than for public entities, due to the additional effort required to compile and support an accurate model.