2012-260
Comment Letter No. 306

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May 31, 2013

SENT VIA EMAIL

Ms. Susan M. Cosper, Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference: 2012-260 - Proposed Accounting Standards Update, *Financial Instruments – Credit Losses (Subtopic 825-15)*

Dear Ms. Cosper:

Moss Adams LLP is pleased to provide a response to the Financial Accounting Standards Board's Proposed Accounting Standards Update, *Financial Instruments – Credit Losses (Subtopic 825-15)* (the "proposed ASU").

Moss Adams LLP is the largest accounting and consulting firm headquartered in the Western United States, with a staff of over 2,000, including more than 260 partners. Founded in 1913, the firm serves public and private middle-market businesses, not-for-profit and governmental organizations.

We appreciate the Financial Accounting Standard Board's (the Board) efforts to comprehensively review the accounting for credit losses of financial assets, including its joint deliberations with the International Accounting Standards Board (IASB). In an increasingly complex and globally connected world, our firm and the middle-market companies we serve routinely operate internationally, and we are supportive of the convergence process. Given the regulated nature of financial entities and the broad impact they have on national and global economies, this may be the most important topic for the boards to achieve convergence on, and we are hopeful that the joint re-deliberation of the proposals will produce a converged outcome.

We are supportive of the Board's use of lifetime expected credit losses as the primary measurement attribute for measuring credit losses, though we have concerns about the operability, complexity and auditability of the proposed ASU, as discussed further below. This measurement attribute should provide more decision-useful balance sheet information to investors than is currently provided in U.S. GAAP at a reasonable cost to preparers. We acknowledge and agree with the concern that the proposed guidance inappropriately results in Day 1 impairment losses on originated financial assets. We observe that the IASB's March 2013 exposure draft would minimize the Day 1 loss issue relative to the FASB's proposal. However, we are concerned that the requirement for an entity to distinguish the period in which they expect a credit loss to occur would be a complex and challenging estimate,

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particularly for smaller entities. Overall, we acknowledge the merits and drawbacks of both the Board's and the IASB's credit loss proposals, and do not believe that one proposal is clearly superior to the other. However, the IASB's model would appear to have the same operability and auditability concerns as the FASB's proposal, as discussed below, with the additional complexity of applying the 12-month requirement. As an estimate of credit losses that incorporates forecasts about future events is highly judgmental and subjective, our view is the Board and the IASB should prioritize having a clear principle and a minimum of operational complexity over other considerations, as our experience is that users, preparers and auditors all benefit from accounting standards with these attributes.

Our support for the Board's proposed measurement attribute is outweighed, however, by concerns about both the auditability of the proposed guidance and its potential for inconsistent application in practice. As drafted, we believe that the provisions to include "reasonable and supportable forecasts" will allow for a range of practice that is so diverse as to be undesirable. One specific concern is that nearly identical entities (and financial entities in particular) will take opposite views about the future yet still be able to find evidence to meet the "reasonable and supportable" threshold necessary to support their respective positions. While we acknowledge that an entity would likely seek information from a range of sources to support their view, a simple review of the range of forecasts available from reputable economists about future economic trends and conditions would demonstrate our concerns about the operability of the proposed guidance. With respect to auditability, and especially in the current public company audit environment, it is unclear to us how we will obtain sufficient appropriate audit evidence to support a company's projections about the future, as the level of evidence required by a company only needs to be "reasonable and supportable," whereas auditors are required to consider all of the available audit evidence, both positive and negative, in determining if management's estimate is reasonable. We are concerned about obtaining sufficient audit evidence when there is significant evidence contrary to management's position, though management has met the "reasonable and supportable" threshold. A similar auditability concern is raised for regulated financial entities where prudential regulators may have a different forecast about future events than management of a company, and "reasonable and supportable" evidence would exist to equally support both positions.

In addition, we believe the Board's proposal would be significantly enhanced by including additional examples and application guidance for nonfinancial entities. The additional guidance should serve to illustrate the level of detail and analysis expected by the Board for these entities. As drafted, the proposal would appear to add complexity to the analysis of routine instruments that are within the scope of the proposal, such as receivables arising from revenue transactions under Accounting Standards Codification Topic 605. For non-financial entities, our experience is that the existing guidance is both operable and produces financial reporting that meet user needs. Given the minimal

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incremental benefit for these entities and their financial statement users, the Board should strive to minimize their costs by providing additional examples or considering practicality or scope exceptions for these types of assets. While we encourage the Board to solicit the views of the Private Company Council (PCC) on the entire proposal, the PCC's feedback on non-financial and smaller entities should be considered particularly critical.

Finally, as noted in our response to Question 16, we are very supportive of the Board removing the troubled debt restructuring distinction from the Codification. We strongly encourage the Board to eliminate this guidance in the final Accounting Standards Update.

Our response and related comments to the specific questions included within the exposure draft are contained in the Attachment to this letter.

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Moss Adams appreciates the opportunity to comment on the proposed ASU. We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience. If you would like to discuss our comments or have any questions, please contact John Donohue in our Professional Practice Group at 206-302-6800.

Yours truly,

Moss Adams LLP

ATTACHMENT

The following are responses to selected questions in the exposure draft:

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?

We generally agree with the scope of financial assets included in the proposed update and understand the Board's rationale for applying a single impairment model to the financial assets with the scope of this proposal.

However, much of the proposed guidance, and specifically the implementation and application guidance, is focused on loan loss accounting for financial entities. Lacking implementation and application guidance, we are not completely clear how the Board intends non-financial entities to apply the guidance. While we acknowledge the Board's concern that the existing guidance resulted in financial entities recognizing loan losses too slowly during the financial crisis, we do not believe that similar concerns were raised at non-financial entities. We are concerned that the additional cost to non-financial entities will be significant with very little benefit for financial statement users. The concern about the additional costs may be mitigated by the Board's inclusion of appropriately scaled implementation and application guidance, though the Board should also consider whether scope exceptions or practicability exceptions may be appropriate.

Finally, we were unable to consider how the proposed guidance would interact with the Board's proposed leasing guidance released in May 2013. Credit loss accounting for lease financing receivables is critical for many entities.

As noted in our cover letter, we believe this is an important question to solicit the views of the Private Company Council.

Question 9 – The proposed amendments would require 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?

We do foresee a number of operability and auditing concerns and constraints in using the information in the proposed guidance to estimate expected credit losses, and we ask the Board consider and address these concerns:

a) We are concerned about the operability of how "reasonable and supportable forecasts" will be incorporated into the analysis of expected credit losses. While we acknowledge and appreciate the Board not being overly prescriptive in its requirements, we are concerned that

the flexibility in the proposed guidance would have a number of drawbacks. For example, there are generally a wide range of expectations about relevant future events, such as economic growth or housing prices, and all of the expectations in that wide range have some level of legitimate and reasonable support that would meet the threshold established in the proposed guidance. An entity could easily justify an expectation about the future that differs from the consensus view as long as a "reasonable and supportable forecast" was obtained. We were unable to determine from the proposed guidance how an entity would determine how far from a consensus view would a supportable forecast have to be before it became "unreasonable." To further that concern, it is unclear how the conditions of "reasonable" and "supportable" should interact. For example, it is not clear if meeting the "supportable" condition, as discussed above, should make a forecast reasonable, or if additional diligence is necessary to determine reasonableness.

b) We are concerned about the comparability of applying the proposed guidance across entities. For example, an entity may choose (or choose not) to apply a counter-cyclical adjustment to its expected credit losses. Further adding to the lack of comparability, even among entities that apply such a counter-cyclical adjustment, differences in judgments on the length and severity of the cyclical changes are likely to be highly subjective and vary across entities. While the Board's proposed disclosures may mitigate some portion of the lack of comparability, the volume and potential magnitude of the differences would appear to overwhelm the ability of disclosure to compensate for the lack of comparability.

c) With regards to operability, we observed no guidance regarding the pooling of instruments in performing the analysis of expected credit losses. With respect to financial entities, there is historical accounting and regulatory guidance that may inform the transition from a pooled approach to an individual asset approach, but it is unclear if the Board wants this historical industry practice to continue. For non-financial entities, and particularly smaller non-financial entities, there are limited historical practices that an entity could look to that would inform it whether the analysis should be performed at a pooled level or not. We believe the Board should clarify its intent on this issue.

d) We are concerned about the auditability of the proposed guidance. Existing audit standards would require consideration of contrary evidence, and there is likely to be "reasonable and supportable" evidence for a position contrary to an entity's position. Further, the proposed guidance effectively adds multiple layers of estimation that auditors will have to assess, including the forward-looking forecasts used to project future losses, the interpretation of where the entity is in the current economic cycle, along with the duration and severity of the current economic cycle. These additional estimates increase the subjectivity of the estimated losses exponentially. Clarified audit standard AU-C 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures,* as well as the PCAOB

Interim audit standard AU 342, *Auditing Accounting Estimates*, have specific requirements pertaining to obtaining sufficient audit evidence surrounding accounting estimates. The highly subjective nature of the estimation process along with the potential for significant contrary information as noted above will make auditing the estimate in the proposal more challenging than current standards. As evidenced by the frequency in which the allowance for loan losses is currently cited in PCAOB inspection reports, auditors are already strained to obtain sufficient evidence to support management's estimate, and our concern is the proposed guidance will increase the level of evidence necessary to audit this estimate, and sufficient evidence may not ultimately be available.

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 loss data and to data to update that historical information to reflect current 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 or to specific data that reflects current conditions and reasonable and supportable forecasts?

While the nature of the entity (i.e. financial vs non-financial entities) is highly relevant to this question, we generally believe that most entities will have access to their historical loss data and general information or data that would provide current conditions and forecasts of the future. For smaller and less complex entities, many of them will lack the sophistication to translate the general information or data into specific expectations about credit losses currently or in the future, particularly for new product lines or business segments.

For nonfinancial entities, historical loss data may not be useful information in predicting future credit losses. For example, an entity may have a significant credit loss from its trade receivables with a customer during a year, but application of the historical loss data may have little or no bearing on the credit quality of the other customers. Non-financial entities are also less likely to have experience estimating credit losses, or incorporating current and forward looking information into their analysis.

For smaller financial entities, we believe that many of these entities lack detailed information about current conditions that would be necessary to apply the guidance in this proposal, such as current loan-to-value ratios, credit scores, and cash flow information. These smaller financial entities have general information about the economy, their markets, and other relevant data, but they generally lack the experience or sophistication to translate the data into a quantitative forward looking adjustment of credit losses.

Finally, the proposed guidance is not clear on how entities that lack historical data (e.g. an entity in the early stages of operations) would apply the proposed guidance. Such entities may or may not have relevant industry data that could be used in place of historical data until that data is available.

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 Illustration 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?

Although we do not see any direct 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, we have concerns about the usefulness of applying the guidance in practice. For high-quality debt instruments, such as U.S. Treasuries, the proposed guidance would require a reasonable amount of work to calculate a credit loss estimate that is clearly trivial. The Board should consider increasing the prominence of the practical expedient, or consider an alternative initial qualitative assessment, to avoid the additional costs to prepare and audit an estimate that may result in a credit loss that is clearly trivial for certain securities.

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?

Overall we do not 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.

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?

Conceptually, we believe most entities should be able to estimate the discount embedded in the purchase price that is attributable to credit at the date of acquisition. The existing model for purchased-credit impaired loans currently requires an estimation of the cash flows not expected to be collected, which we believe to be a similar exercise to the one proposed by the Board. However, we believe there may be complexity if the Board's proposal implied an entity should bifurcate its expected yield on a purchased credit-impaired financial asset to further identify implied credit discounts beyond those resulting from the difference of the contractual face of the asset and an entity's initial expectation of contractual cash flows it does not expect to collect.

The proposed model could encourage overly pessimistic estimates about potential loan losses upon acquisitions of loans, as any improvement would be recognized immediately in income. The existing guidance in ASC Subtopic 310-30 mitigates this risk by requiring an increase in cash flows to be recognized over time as an increase in the accreteable yield. We believe the Board should consider a similar abuse-prevention mechanism. We are very supportive of the potential to reduce the complexity currently associated with applying the guidance in ASC Subtopic 310-30, as that topic is one of the most challenging topics for many financial entities to apply and have audited in practice

There may also be a potential for abuse in how purchased credit-impaired assets are pooled for analysis. In the existing guidance on accounting for purchased credit-impaired loans (ASC Subtopic 310-30), there are certain criteria for loans to be pooled and accounted for as a single unit of account. The basis for requiring the criteria for pooling is, in part, to prevent the inappropriate netting of losses with gains. While this is mitigated, to a degree, from the difference in the proposed model to immediately recognize positive and negative changes in cash flow expectations, there may be a tendency to group loans in a manner to minimize negative credit adjustments.

The definition for purchased credit-impaired financial assets also appears to be narrow in scope. The requirement to recognize an allowance equal to the embedded purchase discount relating to expected credit losses should arguably relate to all loans. The definition requires a "significant deterioration in

credit quality since origination." It is inconsistent with the remainder of the proposed model which requires all expected losses to be recognized at origination. We recommend that the Board consider expanding the definition for purchased credit-impaired financial assets with this in mind.

Question 14 – As a practical expedient, the proposed amendments 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 asset 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?

Overall, the practical expedient appears reasonable, though we believe the expedient would be equally effective and less complex if the Board removed or limited criterion (b). For financial assets valued using Level 1 or Level 2 fair value inputs, meeting criterion (a) should implicitly inform the entity about the level and insignificance of credit losses on an individual financial asset. If, however, the Board retains both criteria, further clarification should be provided on what constitutes "insignificant credit losses" and how entities should determine this estimate, as significant effort could be expended in this determining the credit loss amount, rendering the guidance neither practical nor expedient. We also observe that many regulators are requiring entities to reduce their reliance on credit rating agency scores in risk management and financial reporting, further increasing the potential complexity in applying criterion (b) in the proposed practical expedient.

Question 15 – The proposed amendments would require that an entity place a financial asset on nonaccrual status when it is not probable that the entity will receive substantially all of the 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 this proposed amendment?

The proposed guidance would represent a change for almost all entities, though we believe the degree of the change will be dependent on many factors. We are supportive of the Board's inclusion of guidance with respect to non-accrual financial assets, and believe most entities should be able to apply the guidance without significant operability or auditing concerns, except as discussed in the next paragraph.

As illustrated by the Board's current project to improve the accounting for loan losses, the determination of when an event is considered "probable" is challenging to apply in current practice, and we are concerned that the proposed guidance would expand those challenges. For example,

existing guidance requires that a loan be considered impaired when it is probable that not all contractual cash flows will be collected. In practice, most regulated banking entities either wait for a discrete event or a period of non-payment (e.g. 90 days past due) prior to classifying a loan as an impaired loan. While this practice is a reasonably proxy for the existing requirements, there remains a period of time between the actual moment the collection of cash flows are no longer probable and when the discrete event (e.g. 90 days past due) triggers recognition for accounting purposes. Also, current practice does not differentiate between interest and principal payments not to be received, which the Board's proposal would require. Regulated banking entities currently look to the definition of an impaired loan, for which all contractually due principal and interest payments are not expected to be collected in accordance with terms, and have not historically had to differentiate between cash flow payment types. Finally, we observe that the Board has generally chosen not to introduce probability thresholds in other areas of the proposed guidance.

Question 16 – Under existing U.S. GAAP, the accounting by a creditor for a modification to an existing debt instrument depends on whether the modification qualifies as a troubled debt restructuring. As described in paragraphs BC45-BC47 of the basis for conclusions, the Board continues to believe that the economic concession granted by a creditor in a troubled debt restructuring reflects the creditor's effort to maximize its recovery of the original contractual cash flows in a debt instrument. As a result, unlike certain other modifications that do not qualify as troubled debt restructurings, the Board views the modified debt instrument that follows a troubled debt restructuring as a continuation of the original debt instrument. Do you believe that the distinction between troubled debt restructurings and nontroubled debt restructurings continues to be relevant? Why or why not?

We do not consider the distinction between troubled debt restructurings (TDR) and non-troubled debt restructurings to be meaningful, particularly with a credit impairment model that requires recognizing lifetime expected losses for all loans. The significant burden to identify and track troubled debt restructurings is not justified by the limited benefit, in our view, received by users of financial statements.

In practice, there is also a significant diversity with regard to removing the TDR designation and maintaining an allowance for credit losses. Under existing GAAP, we often observe an allowance amount for a historically troubled credit that has been restructured less than loans that have not been restructured. Also, more relevant than disclosures about TDRs is disclosure regarding internal credit grading and the underlying performance of the asset (e.g. accrual vs. nonaccrual status), which are both covered by the disclosure requirements of ASU 2010-20. The Board should also consider replacing the TDR disclosures with disclosures about loan renewals and extensions, particularly for loans with low internal credit grades, as this information would be more meaningful for users and generally less costly to prepare.

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

We do foresee some significant operability and auditing concerns/constraints in complying with the disclosure proposals. In proposed paragraph 825-15-50-9b, it is not clear how auditors would audit what "influenced" management's estimates of current expected credit losses. This requirement seems more appropriate as a Management's Discussion & Analysis requirement. The proposed disclosure in paragraph 825-15-50-9e for identification of "any change" to accounting policies, the rationale for it, and to require it by portfolio segment is a significant burden to both prepare and audit. It is also challenging to understand, in proposed paragraphs 825-15-50-19 and 50-20, how an entity should aggregate the information, and we also question whether its usefulness outweighs the significant costs.

The implementation guidance and illustrations should include additional examples of the disclosures to help entities comply with the proposed disclosure requirements.

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?

In general, additional implementation guidance and illustrative examples are necessary, specifically for different industry groups. For example, an example for health care entities should be included, given the unique considerations in health care reimbursement. Further, in example 5's illustration on trade receivables, clarification could be provided on how this example estimate considers the two outcomes (one with losses and one without losses) as well as the implicit or explicit time value of money consideration. The example is too simple given the requirements of the proposed standard to consider time value of money and the two outcome requirement. Also, an example with a business combination (or other purchase of loans) that are both credit-impaired and non-credit impaired would be helpful.

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

We agree with the transition provision in this proposed Update.

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

We agree that early adoption should not be permitted.

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?

Our view is that nonpublic entities should have a later adoption date than public entities. Typically public companies have more resources to gather the data necessary to support the estimation process and to complete the required disclosures.

Question 23 – Do you believe that the transition provision in this proposed Update is operable? If not, why?

Overall, we believe that the transition provision in this proposed Update is operable.

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?

We believe that at least three years would be needed to implement the proposed guidance. Although we cannot comment directly on the operations changes and technology systems enhancements necessary to implement the proposal, our understanding is that they would be substantial for both large and small entities.