



PCPS

PRIVATE COMPANIES PRACTICE SECTION



April 1, 2009

LETTER OF COMMENT NO.

308

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Re: March 17, 2009 Proposed FASB Staff Position (FSP) FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Proposed FSP and is providing the following comments for your consideration.

GENERAL COMMENTS

Application of accounting standards related to other-than-temporary impairment ("OTTI") of debt and equity securities is one of the most difficult issues and sources of contention between preparers and practitioners that exists. Additional guidance with respect to applying the standards is certainly welcome. However, it is an open question as to whether this guidance, when applied in practice, will improve financial reporting or will in fact lead to safe harbors, in particular for equity securities, wherein there are very few, if any, OTTI charges recognized in earnings. We do not believe that was the intent of the Board, but this may be the unintended consequence.

By moving from the ability-and-intent-to-hold threshold to a "no intent" and "more likely than not to sell" filter, it is highly likely, except for entities with severe liquidity crises, that many entities would make these assertions when determining whether or not the OTTI exists.





This position seems to be supported by the examples related to marketable equity securities in the appendix. Herein, for each scenario, no matter what the duration or severity of the price decline, the company takes the position that, because it does not intend to sell and it is unlikely that it will need to sell, no impairment exists. Is it realistic, especially for equity securities, to assert, that a company will hold on to such a security for such a long period of time? It does not appear to be rational.

The guidance with respect to debt securities also seems counterintuitive. Under paragraph 13 of the proposal, once an entity meets the no-intent-to-sell criteria, it can apparently avoid an OTTI charge simply by asserting that it believes the cash flows are likely to be received, without considering possible evidence to the contrary. Once again, the corporate bonds example on page 16 of the Proposed FSP illustrates this rationale. In the example, the investor concluded that the decline in the issuer's credit rating from A to BBB apparently had no bearing on the company's evaluation of its ability to collect all amounts due according to the contractual terms of the investment. If the standard is predicated on the concept that OTTI includes an inherent credit loss component, then it seems logical that a significant ratings decline should present a rebuttable presumption that an OTTI exists due, at least in part, to credit risk, which should be recognized in earnings. TIC therefore suggests that the FASB consider whether a credit risk downgrade, in and of itself, should be a requirement for a credit risk charge to earnings as an OTTI, unless strong, contrary evidence exists that contradicts the implication implied by the decline in the issuer's debt rating.

In attempting to provide more guidance, it appears that perhaps the Board has inadvertently provided some "safe harbors" for not taking impairment charges. We urge the board to reconsider the approach. At the least the Board should provide some examples wherein the circumstances would lead the entity to conclude that an OTTI charge was necessary related to other factors besides their intention not to sell.

RESPONSES TO STAFF QUESTIONS

- 1. This proposed FSP would require entities to separate (and present separately on the statement of earnings or "performance indicator") an other-than-temporary impairment of a debt security into two components when there are credit losses associated with an impaired debt security for which management asserts that it does not have the intent to sell the security and it is more likely than not that it will not have to sell the security before recovery of its cost basis. The two components would be (a) the credit component and (b) the noncredit component (residual related to other factors). Does this separate presentation provide decision-useful information?*





TIC believes that this would provide decision-useful information if it also required transparent disclosures of how the decisions were made as to the split between credit and other losses, the assumptions, etc.

- 2. This proposed FSP would require that the credit component of the other-than-temporary impairment of a debt security be determined by the reporting entity using its best estimate of the amount of the impairment that relates to an increase in the credit risk associated with the specific instrument. One way of estimating that amount would be to consider the measurement methodology described in paragraphs 12–16 of FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan. For debt securities that are beneficial interests in securitized financial assets within the scope of Issue 99-20, the amount of the total impairment related to credit losses would be determined considering the guidance in paragraph 12(b) of Issue 99-20. Do you believe this guidance is clear and operational? Do you agree with the requirement to recognize the credit component of an other-than-temporary impairment in income and the remaining portion in other comprehensive income? Under what circumstances the remaining portion should be recognized in earnings?*

We believe that the guidance would work better if, in paragraph 2, the concept of credit losses was defined—either as a presumption that contractual cash flows will not be achieved or other objective information, such as a ratings change. Once the concept of credit losses is clarified, an entity may be able to apply the guidance in FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, and EITF Issue No. 99-20, *Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets*. Although in some situations, the information may be difficult to ascertain. In any case, when using discounted cash flow modeling for determining the credit loss component, the assumptions should be those of a market participant rather than solely those of the entity.

The entire impairment loss should be recognized in earnings if the entity has no logical way to separate the credit loss from other factors. In other words, the default position should be to recognize the loss in earnings and work backward to reducing the amount recognized if sufficient information is available to determine the credit loss component.

- 3. This proposed FSP modifies the current indicator that, to avoid considering an impairment to be other than temporary, management must assert that it has both the intent and the ability to hold an impaired security for a period of time sufficient to allow*





for any anticipated recovery in fair value. The Board believes that, compared to current requirements, it is more operational for management to assert that (a) it does not have the intent to sell the security and (b) it is more likely than not that it will not have to sell the security before its recovery. Does this modification make this aspect of the other-than-temporary impairment assessment more operational (the remaining factors discussed in FSP FAS 115-1/FAS 124-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, would remain unchanged)? Should this modification apply to both debt and equity securities? Will this change result in a significant change to the assessment of whether an equity security is other-than-temporarily impaired?

The revised definition is most likely more operational; however, it is problematic when this issue is emphasized to the extent that it is in the FSP. That is, the other factors noted as impairments are diminished in significance. This is supported in particular in the examples, wherein there are no situations that result in impairment, simply because the entity asserts it does not intend to sell.

Taking that position with equity investments is particularly at odds with economic realities. Can anyone assert that an equity investment that has declined by say 90% is not other than temporarily impaired, no matter what management's intent? It seems illogical on its surface.

We believe that this FSP will be more workable with debt versus equity investments. For example, this FSP seems to be particularly workable in situations wherein the entity holds debt instruments with relatively short maturity dates. In these cases, if it is likely that they will get paid and the entity can wait until the redemption date, then the standard is workable.

TIC believes this proposal will result in a significant change in practice with less impairment charges as a result.

- 4. This proposed FSP would require that the portion of an impairment recognized in other comprehensive income for held-to-maturity securities be amortized (through other comprehensive income) over the remaining life of the debt security in a prospective manner based on the amount and timing of future estimated cash flows by offsetting the recorded value of the asset (that is, an entity would not be permitted to adjust the fair value of a held-to-maturity security for subsequent recoveries in the fair value of the security similar to the accounting for available-for-sale securities). Do you agree with this requirement?*





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PRIVATE COMPANIES PRACTICE SECTION

We have no comment with respect to this issue, as our constituents rarely utilize the held-to-maturity classification.

5. *Is the proposed effective date of interim and annual periods after March 15, 2009, operational?*

This is a very short window for implementation. TIC believes that the effective date for this proposal and Proposed FSP FAS 157-e, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed*, should be the same. Therefore TIC recommends that the effective date for this proposal be deferred to interim and annual periods ending after June 15, 2009, with earlier application permitted.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen Bodine, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

