

August 26, 2009

Mr. Russell Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
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File Reference No. 1700-100—Exposure Draft, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*

Dear Mr. Golden:

BDO Seidman is pleased to offer comments on the Exposure Draft of the Proposed Statement of Financial Accounting Standards, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses*. We agree that enhancing disclosures about an entity's exposure to credit losses will improve the transparency of financial reporting, but we do not believe the proposed effective date is operational. It should be deferred for a year to improve the quality of information disclosed in future financial reports. We also believe certain proposed disclosures may not contribute to a user's understanding of credit risk and should be removed from the final standard.

Effective Date

The ED proposes an effective date one month after Statements 166¹ and 167² must be adopted. While the implementation of any new major standard requires significant time and effort, Statements 166 and 167 directly impact the population of receivables subject to the ED. Certain transfers treated as a financing will increase the number of assets for which credit disclosures would be required. More importantly, some entities will be consolidated for the first time under Statement 167, and in short order, management teams will be required to assess the realizability of assets they haven't previously managed. Further, it isn't difficult to envision a debtor becoming the ward of its creditor as a newly-consolidated variable interest entity. In its revision of Statement 167's reconsideration events, the Board contemplated this scenario when it described

an entity previously considered to be a voting interest entity...[that] experienced severe losses such that the holder(s) of the equity investment as a group lost the power from the voting rights...of those interests, and thus, another party (*for example, a guarantor or lender*) obtained a controlling financial interest in the entity....³

We question whether new, expanded credit disclosures prepared in this context on a short timeline would represent high quality financial reporting.

As an additional challenge, many public companies will be required by Sarbanes-Oxley to implement and assess internal controls related to the disclosures required by this ED. Further, all

¹ *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140*

² *Amendments to FASB Interpretation No. 46(R)*

³ Paragraph A23, Statement 167, italics added.



companies (public and private) will need time to modify their information systems to capture information in a format suitable for the proposed disclosures. We believe these factors and the pending adoption of Statements 166 and 167 necessitate an additional year of lead-time. This should result in a more thoughtful approach to developing credit risk disclosures. In the meantime, we note companies are not prohibited from providing additional credit disclosures, a theme the SEC staff affirmed in its August 2009 “Dear CFO” letter.⁴

Lastly, we note the Board’s current joint project on financial instruments with the IASB may significantly impact which instruments are carried at fair value vs. other measurement attributes, and as a result, influence the population of instruments for which the ED’s credit quality disclosures would be useful. An additional year of deferral would provide insight into this dynamic, and perhaps avoid unnecessary revisions to the ED that would stem from the final financial instruments standard.

Responses to Questions

Issue 1: This proposed Statement defines a financing receivable as both loans as defined by FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, and lessors’ investment in leases other than operating leases that have been recorded as assets in accordance with FASB Statement No. 13, *Accounting for Leases*. Do you agree with the definition used to identify a financing receivable subject to the provisions of this proposed Statement? If not, why not?

We generally agree with the definition of a financing receivable. However, we believe paragraph 3 should be revised to exclude receivables carried at fair value, for instance under Statement 159.⁵

Because the ED seeks to provide insight into the basis for management’s determination of the allowance, disclosures based on management’s methodology are appropriate. However, disclosures—whether at the portfolio or class level—that are created for the sole purpose of complying with the ED will not provide incremental insight into management’s process. Paragraph 6(b) appears to limit the level of disaggregation to that used by management in the normal course of its operations, including compliance and regulatory reporting. We believe adding a provision to the final standard making that notion explicit would be helpful, similar to paragraph 34(a) of IFRS 7.⁶

As an example, we believe the definition of “portfolio segment” and “class of financing receivable” should be clarified because it appears those terms could overlap. At small and medium-sized banks, we are uncertain a clear distinction will always exist between “the level at which the creditor develops and documents a systematic methodology to determine the allowance (i.e., portfolio segment)” versus the category of borrower, type of receivable, industry sector, etc. (i.e., a particular class of financing receivable). In some cases, we understand creditors base their allowance methodology on one of the categories the Board used to illustrate a class of receivable in paragraph 6(b). If the ED is interpreted to mandate additional, more granular disclosures to satisfy the class requirement in paragraph 6 based on information management does not presently need or use, we do not believe that outcome would be consistent with the proposal’s basic intent.

⁴ See <http://www.sec.gov/divisions/corpfin/guidance/loanlossesltr0809.htm>.

⁵ *The Fair Value Option for Financial Assets and Financial Liabilities*

⁶ *Financial Instruments: Disclosures*



Issue 2: This proposed Statement would apply to all creditors, including all public and nonpublic entities that prepare financial statements in accordance with generally accepted accounting principles. Do you agree with the scope of this proposed Statement? If not, why not?

In general, we believe GAAP should apply equally to all entities. With respect to this ED, we note many small creditors such as private community banks distribute financial statements on a limited basis, for instance, to a small number of board members, shareholders and regulators. Those parties are typically in close contact with the bank and regularly review internal credit risk analyses and regulatory reports. For those reasons, the incremental benefit provided by these disclosures may not outweigh their cost. In contrast, many public company investors depend on financial statements and other publicly-available information to manage their investments. Accordingly, we recommend the Board consider a scope exception for smaller private entities, similar to the one provided in Statement 126.⁷

Issue 3: This proposed Statement would require a rollforward schedule of the total allowance for credit losses in both interim and annual reporting periods by portfolio segment and in the aggregate. In addition, it also would require a rollforward schedule of financing receivables in both interim and annual reporting periods by portfolio segment and in the aggregate. Do you believe those disclosures will assist financial statement users in better understanding the financial information for the total allowance for credit losses as well as the associated financing receivables? If not, why not?

We believe a rollforward schedule in each period of the total allowance by portfolio segment and in the aggregate will assist in the understanding of credit losses. For instance, users will be able to compare prior increases to the reserve against actual write-offs. Users may find this helpful in forming an opinion about the relative accuracy of managerial projections that were developed based on the company's accounting policies.

However, the *incremental* benefit of a financing receivables rollforward is unclear, assuming the allowance rollforward is retained in the final standard. Said differently, it is not apparent how a receivables rollforward will enhance a user's understanding of credit quality beyond what the allowance rollforward will provide.

With respect to the requirement in paragraph 11(c) to separately present portions of the allowance determined on the basis of individually and collectively evaluated financing receivables, we note the first example in appendix A lacks a line item to display transfers between these two categories and recommend adding one. In addition, this separate presentation should provide insight into management's provisioning method, but such disclosures may not be easily compared from one creditor to the next because their provisioning methods may vary.

Issue 4: This proposed Statement would require interim and annual credit quality disclosures about a portfolio by class of financing receivable, including quantitative and qualitative information about the credit quality of financing receivables. Do you believe those disclosures will assist financial statement users to better understand the credit quality for the associated financing receivables? If not, why not?

⁷ *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities.*



We believe credit quality disclosures such as internal risk ratings and consumer risk scores will assist users in their understanding of credit risk. As discussed above, we believe the level of disaggregation should reflect the approaches used by management in its normal course.

The requirement in paragraph 13(b)(1) for a creditor to compare its internal risk ratings to the federal regulatory ratings of pass, special mention, substandard, doubtful, and loss seems inconsistent with the “management approach” underlying the ED. Financial statement users presumably have an adequate understanding of the regulatory environment in which a creditor operates, and managerial approaches will vary from one entity to the next, by design. Consequently, requiring a comparison of internal risk ratings to the relevant regulatory benchmark may have the unintended consequence of generating boilerplate disclosures that are not informative.

Issue 5: This proposed Statement would require an analysis of the age of financing receivables that are past due, but not impaired, at the end of the reporting period separately for each class of financial instruments. Do you believe those disclosures will assist financial statement users in better understanding the credit quality for the associated financing receivables? If not, why not?

We believe aging analyses assist in the understanding of credit quality, particularly with respect to credit trends evident in a company’s receivables. Consequently, we believe the requirements in paragraph 13(d) and (e) should be clarified to indicate there are no prescribed aging categories, such as groupings based on 30, 60 and 90 days. Rather, these should be tailored to the company’s business model and the approaches used by management in its normal course. Additionally, the Board may wish to consider requiring or encouraging comparable aging analyses for the immediately preceding period, as changes from one quarter to the next may be highly informative to users.

Issue 6: This proposed Statement would require the fair value of loans at the end of the reporting period by portfolio segment. Do you believe those disclosures will assist financial statement users in better understanding the credit quality for the associated financing receivables? If not, why not?

We do not believe that fair value disclosures enhance an understanding of credit quality. While we believe fair value information for certain financial instruments is beneficial to users, we note that fair value is an exit price notion under Statement 157.⁸ Credit risk, which is primarily concerned with a borrower’s ability to repay, is only one of several risk factors (e.g., interest rate and liquidity risk) incorporated into fair value measurements. Further, recent criticism by some constituents of mark-to-market accounting focused on the magnitude of liquidity discounts that are required to estimate the fair value of certain assets that are not actively traded. In that context, the relevance of fair value to a user is clear. However, that objective differs from efforts to facilitate or enhance an investor’s understanding of a company’s exposure to credit risk—whether in the aggregate or by portfolio segment.

In addition, we note requiring interim disclosures of fair value for private companies with receivables in the scope of this ED would be inconsistent with the option provided by FSP FAS 107-1 and APB 28-1.⁹

⁸ *Fair Value Measurements*

⁹ *Interim Disclosures about Fair Value of Financial Instruments*



If the Board ultimately requires the fair value of loans to be disclosed, we recommend supplementing the Basis for Conclusions with a discussion of the role that fair value information plays in understanding credit risk.

Issue 7: Do you believe it is operational for entities to disclose all of the proposed requirements for interim and annual reporting periods? Why or why not?

We believe interim and annual disclosures will be operational, allowing for the scope exception we propose in response to Issue 2. Further, we believe the impact of initial “start-up” costs to comply with this proposal will be mitigated if the Board defers its effective date for another year.

We appreciate the Board’s efforts through this ED and other recent initiatives that have responded to requests for additional transparency into the accounting and disclosure for financial instruments. The natural consequence of these requests and new standards is an ever-expanding set of interim financial reports. We encourage the Board to continually compare the benefits of each new standard not only to its specific costs, but also to the marginal impact it has on the body of existing GAAP. In this regard, we strongly support the Board’s goals in its new project to develop a Disclosure Framework. We believe the principle of diminishing marginal returns should be a guiding element of those deliberations. This should enable users to focus on key issues each interim period rather than obscuring important information with excessive details.

Editorial Comment

Paragraph 13(c) begins “For financing receivables carried at a measurement other than amortized cost (*fair value, the lower of cost or market, or present value of amounts to be received*) that are neither past due as determined by management’s policy nor impaired as defined by Statement 114....(italics added)” This seems to imply a receivable carried at fair value or LoCoM must be tested for impairment under Statement 114 as a condition for disclosing quantitative information about credit quality under the ED. We suggest clarifying this sentence, perhaps to indicate the requirement in 13(c) does not apply to instruments excluded from the scope of Statement 114 (paragraph 6), if that is the Board’s intent.

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We would be pleased to discuss our comments with the FASB staff. Please direct questions to Lee Graul, National Director of Accounting, at (312) 616-4667.

Very truly yours,
BDO Seidman, LLP