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March 31, 2011

VIA EMAIL TO: director@FASB.org

Technical Director
File Reference No. 2011-150
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Re: Supplementary Document, *Financial Instruments: Impairment*

To Whom It May Concern:

We are responding to the FASB and IASB Supplementary Document, *Financial Instruments: Impairment*, dated January 31, 2011 (the "joint proposal" or "proposal" or "proposed model"). Our firm, Financial Reporting Advisors, LLC, provides accounting and SEC reporting advisory services, litigation support services, and dispute resolution services. We specialize in applying generally accepted accounting principles to complex business transactions. We appreciate the opportunity to provide comments.

Overall Comments

We applaud the FASB's and IASB's efforts at convergence and the serious consideration being given to the feedback received on their separate proposals. Given the porousness of international borders in the origination and transfer of financial assets (as demonstrated by the recent financial crisis), we believe accounting for the impairment of financial assets is the most important component of the financial instruments project on which to converge. It is an area where comparability and transparency are difficult irrespective of the model chosen. The challenge is therefore to create a conceptually sound model that is likely to be understood, implemented and applied on a relatively consistent basis, not only across national borders and financial institutions but also across similar financial assets.

We believe the project on impairment of financial assets is also one of the more important projects undertaken by the FASB and IASB in recent years. We say this knowing full well that the Boards are contemporaneously addressing critical and pervasive topics such as revenue recognition and leases. However, while all of these major projects are complex and capable of stirring intense debate among

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accountants, the accounting for the impairment of financial assets stands apart from the others because it is politically charged. Everyone, it seems, has a strongly held point of view on the adequacy of allowances for loan losses and how those allowances should be established. Those diverse points of view are naturally colored by the recent financial crisis and the claims that the reporting of losses by financial institutions in an economic downturn exacerbates or prolongs a crisis. It is our view that while accounting standards need to change in response to identified weaknesses, they also need to remain independent of any underlying bias that is inconsistent with the objective of general purpose financial reporting: to report economic events as they happen.

Our principal comments regarding the joint proposal are twofold.

1. We believe the accounting model for impairments of financial assets should be based on a sound, well-reasoned, clear concept that will withstand the challenges of economic cycles. Anything less will lead to significant operational and implementation problems, confuse or even mislead users of general purpose financial statements, and have far reaching consequences for other areas of accounting. In our view, the conceptual underpinnings of the joint proposal are at best elusive and at worst unsound.
2. We believe the accounting model for impairments should be based on the objectives of general purpose financial reporting: providing information about an enterprise's financial condition and performance to investors and creditors for their use in making rational investment, credit and similar decisions. Allowing the differing interests and objectives of governments, regulators, policy makers and politicians to influence the outcome of this accounting standard will inevitably damage the independence and integrity of the accounting standards setting process. Having observed the development of accounting standards for more than three decades, we recognize and appreciate the need for accounting standards setters to compromise, to occasionally issue a standard with less rigorous requirements or a less than perfect conceptual basis in order to improve financial reporting broadly. Progress often comes in small steps. We fully support the Boards in making pragmatic decisions when the result is an improvement in financial reporting. But those small steps and pragmatic decisions should not take us backwards. In our view, the joint proposal does just that. It is a compromise that brings the Boards together and perhaps appeases certain prudential regulators but in the process steps back to a time when providing reserves to cover foreseeable or expected rainy days was generally accepted. We are concerned that the joint proposal represents a shift in a fundamental concept of financial reporting, specifically, the sharp (and important) distinction that is made between past and future events.

We fully agree that the current accounting model for impairments of financial assets needs improvement. We believe it suffers from two problems: (a) delayed recognition of allowances for credit losses ("reserves") and (b) inconsistencies and application challenges in practice. We therefore completely support the Boards in their efforts to change and improve the standards in this area. Our detailed comments identify what we perceive to be the significant weaknesses in the proposed model and why it does not represent an improvement in financial reporting. We also offer our recommendations as to a way forward.

Underlying Concept

In our view, the concept that underlies the proposed model is at best elusive. Both Boards apparently believe that impairments should be estimated at the inception of a loan portfolio based on expectations

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of losses that will occur in the future. Both Boards also appear to believe that management can make reasonable, reliable estimates of all expected losses for the life of the instruments. But the Boards differ in when to recognize those losses. As a result, the proposed accounting for impairments of financial instruments is neither an incurred loss model nor an expected loss model nor even a model that reserves for losses expected in the foreseeable future. It would appear to us that the amount of impairment recorded by an entity will be a mechanically derived number that tries to marry the “matching” concept (the notion that credit losses represent a yield adjustment over the life of the loan) to a distant cousin of the “lower of cost or realizable value” concept (the notion that the assets should not be carried at an amount in excess of foreseeable collections). In the world of tangible assets, the proposed model is the equivalent of recognizing a reserve for obsolete finished goods inventory based not on the goods that are currently obsolete, nor based on future events that are expected to make the goods obsolete, nor even based on the amount of obsolescence that is expected to occur in the near term, but rather based on an allocation formula with a floor. As we stated earlier, the concept eludes us.

Admittedly, the joint proposal is a compromise that attempts to meld the views of the two Boards. But even a compromise should be based on a mutually agreed upon goal. We struggle not only with articulating the concept underlying the proposed model but with understanding its goal. After several readings, the best we can say is that it would appear the objective of the joint proposal is to (a) increase allowances for credit losses compared to current practice and (b) build reserves faster when economic times are good. To us, this is not a sound financial reporting goal.¹

By way of further explanation, we note the following:

- The Boards’ preference for an expected loss model implies that recording “actual losses” when they occur (and not before they occur) is a weakness of the current model. We struggle with that implication, particularly in light of other areas of accounting and the conceptual framework, as discussed further below. While the incurred loss model presents operational difficulties, we believe that recording losses when they occur is an appropriate means of reporting the consequences of economic events to investors and creditors in general purpose financial statements.
- In reading the joint proposal as well as some of the comment letters received by the Boards on their separate proposals, we sense that a regulatory agenda underlies some of the current thinking on impairments of financial assets, an agenda that has “larger reserves” as its goal. This agenda may be appropriate from a public policy perspective, but it is not a good development for financial reporting. Financial reporting should “tell it like it is.” If “larger reserves” are appropriate as a matter of macroeconomic policy or to achieve safety and soundness in the financial system, then those objectives should be achieved with regulatory tools.
- Regarding the Boards’ preference for an expected loss model, we observe that many things are “expected”—there is no end to the possibilities. That does not mean we should accrue for them currently.
- The joint proposal conflicts with the asset/liability model that underlies much of the Boards’ recent standard setting. The joint proposal seems focused on “getting the income statement ‘right,’”

¹ We also note that, based on our experience, application in practice is improved when the accounting model is based on a clear concept rather than simply a desired outcome.

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spreading losses over the term of the loan and limiting income statement volatility by building reserves for a “rainy day.” To us, that seems inconsistent with the notion that the income statement should portray the changes in assets and liabilities during the period.

- Some proponents of the expected loss model argue that an institution prices loans (i.e., sets interest rates) to cover its expected credit losses. Under this premise, loan losses are not discrete events: they are yield adjustments that are embedded in the overall income stream. The accounting model should therefore reflect losses over the same periods as interest income—otherwise earnings are overstated in early periods because losses typically emerge later.² Perhaps in the broader economy, over long periods of time and economic cycles, there is a basis for that observation. But individual financial institutions compete in a marketplace in which pricing is heavily influenced by competitive factors. “Bank A” charges a specific interest rate for auto loans in order to match the current market rate (which is, of course, affected by an often-changing mix of both current and longer-term factors), not based on a long-term macroeconomic model. “Bank A” can choose to exit certain markets if it believes current rates are too low to cover losses, but having decided to finance auto purchases, it charges what the market will bear. Furthermore, accounting is done at the individual company level not at the broad economy level, and an individual company’s experience will often deviate from economy-wide averages.
- Stipulating that 12 months is the “minimum period” for the foreseeable future floor is neither a concept nor a principle. Further, requiring a floor on reserves can result in a “day one” loss even given sound underwriting—a result difficult to understand and explain. In such circumstances, the carrying amount of the loans at origination would be less than fair value, another concept we find difficult to articulate.
- The joint proposal focuses on open portfolios of relatively homogenous loans. It does not appear to us that the proposed model can be applied to an individual loan or security (discussed further below.) This to us indicates a weakness in underlying concept. A model with a sound, understandable concept can be applied to portfolios (open or closed), single items (loans and securities), purchased assets and originated assets as well as trade receivables.³ While detailed implementation techniques may differ from situation to situation, the concept underpinning the impairment guidance for financial assets should remain the same. Further, a sound underlying concept reduces complexity, thereby improving operationality and implementation. The more “exceptions” there are to a model, the more questions there are about when the exceptions apply. And the less consistency there is across models, the more important the artificial distinctions that separate the models become.

² The same premise could be said to underlie many other business transactions. See the next section of our letter for comments about major maintenance events for which the required accounting is quite different from the proposal.

³ We recognize that the Boards are addressing initial recognition of trade receivables in the Revenue Recognition project. We would like to believe, however, that whatever concept the Boards develop for recognizing subsequent impairments on “loans” would apply to “trade receivables.”

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In summary, we believe the amount that an entity would report as an impairment allowance under the proposal could only be explained by the procedural mechanics used to generate it.⁴ In our view, this is not an improvement in financial reporting.

Concerns about Broader Implications

At the core of the joint proposal is the notion that impairments should be recorded based on “expected” losses, i.e., losses that are predicted but have yet to occur. This is a significant departure from the longstanding accounting principle requiring a loss to be recognized when incurred (including incurred but as yet unreported losses). We are concerned about the broad implications of the “expected loss” model in other areas of accounting given that both the conceptual framework and existing standards have made a sharp distinction between past and future events.

The conceptual frameworks of both the FASB and IASB offer definitions of assets and liabilities as follows (emphasis added and footnotes omitted):

- FASB

“Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.”

“Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.”

- IASB

“The assets of an entity result from past transactions or other past events.”

“Liabilities result from past transactions or other past events.”

This same sharp distinction between past and future events is also evident at the standards level. A handful of examples follow. In each example, we note that the timing of the recognition of items is dependent on a clear distinction between past and future events.

1. The incurred loss model underlying ASC 450, *Contingencies*, and implications by analogy to areas beyond loan loss accounting.
 - Loss recognition for uninsured accidents/events.

⁴ Were the Boards to “field test” the joint proposal, it would be instructive to ask preparers to accompany the quantitative results with a narrative explaining the impairment provision and changes in impairment related metrics, similar to what might be presented in a “Management’s Discussion and Analysis” or “Management Commentary.” This might help the Boards conclude on the extent to which the product of the proposed accounting model is understandable to users of financial statements. Further, it would be of interest as to what preparers would actually say given that they follow a very different approach for internal credit risk management purposes.

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- Incurred losses (accidents and catastrophes) in the insurance industry.⁵
- Extended warranty loss recognition.
- Loss recognition for letters of credit.⁶
- Loss recognition for unasserted claims.

In all cases, the literature requires that losses—and gains—be recorded based on past events, i.e., events that have occurred as of the balance sheet date. The recognition of losses related to future events, such as the occurrence of a natural disaster, an expected change in contractual warranty coverage, or workplace injuries or similar accidents, is clearly prohibited.

2. Accounting for uncertain income tax benefits as well as other income tax issues, for example, accounting for tax law changes. Even in circumstances where a change in tax law is reasonably certain of enactment, recognition prior to enactment is prohibited.
3. Accounting for costs associated with exit and disposal activities. Accruals are not permitted based on an expectation of restructuring, regardless of management's ability to estimate its occurrence.
4. Accounting for asset retirement obligations. The measurement of an asset retirement obligation considers uncertainties in how and when performance will occur, but recognition is tied to the incurrence of the obligation.
5. Accounting for Type 1 (recognized) vs. Type 2 (nonrecognized) subsequent events. The classic example is the fire that burns down the company's factory shortly after year-end. That economic loss is disclosed but is not recorded in the year-end financial statements on the basis that the loss had not yet occurred.
6. Accounting for the impairment of long-lived assets. The examples of triggering events for testing a long-lived asset for recoverability are all based on "events or changes in circumstances" that have occurred as of the balance sheet date.
7. Accounting for unrealizable, obsolete and excess inventories. The "lower of cost or market" principle requires an assessment of market based on current conditions and prohibits a company from recognizing a reserve "unless the evidence indicates clearly that a loss has been sustained."
8. Accounting for major maintenance events for airplanes, power plants, oil refineries, and so forth. Entities are prohibited from accruing for expected major maintenance events. Arguably, income is "overstated" in the early years before the required major maintenance, the costs of which are considered broadly in pricing similar to interest rates and credit losses. Further, these costs are easily predictable.

⁵ We recognize that insurance industry accounting is currently being addressed by both Boards.

⁶ We recognize that the IASB asks about this topic in this proposal.

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9. Accounting for business combinations, specifically, the timing of recognition of assets acquired and liabilities assumed.

The above examples are from the US literature but similar examples can be drawn from the IASB's literature—see, for example, IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

With respect to the expectation of future events, some might argue that the joint proposal seems more consistent with the fair value model (which embodies market participants' expectations about the future) rather than the amortized historical cost model (which the proposal purports to address). However, this speaks to the confusion some encounter in distinguishing between recognition and measurement. Concepts of "current market" or "fair value" necessarily include expectations of the future. But our concern is with the trigger for recognizing a loss, not with the measurement of it. An accounting model that requires companies to anticipate future losses is an accounting model that encourages the establishment of reserves for the inevitable "rainy day." And if it is appropriate to expect "rainy days" when recognizing an impairment for a portfolio of financial assets, why should it be unacceptable for other assets, or even for liabilities? Should a company with a large fleet of trucks reserve for future accidents based on the reasonable expectation that accidents will occur either in the foreseeable future or at some time over the life of the fleet?

In summary, we are concerned that by introducing a requirement to anticipate future events in establishing a reserve for financial assets, the proposed model compromises the longstanding, important distinction made in the accounting literature between past and future events. We are concerned about the precedent this proposed model would establish and the broad ramifications to other areas of financial reporting. If the Boards firmly believe in the soundness of the expected loss concept, i.e., the notion that entities should recognize losses before the event that causes them occurs, then extending that expected loss concept to other financial reporting topics would appear inevitable. In our view, this would reduce significantly the usefulness of financial statements.

Operationality and Other Concerns with the Proposal

In addition to our concerns with the concepts that underlie the joint proposal, we believe the proposal presents operational challenges. We can suggest several that occur to us; no doubt there are others.

Applicability to Individual Items

As the Boards know, not all entities that hold financial assets have large books of homogenous loans. But the concept of estimating expected losses for the "good book" does not seem to fit when assessing the impairment of an individual loan or security. How would an entity utilize a statistical method to estimate the expected loss of an individual item? Would relevant statistics exist? And even if relevant statistics are available, should they be applied to an individual item? It seems that following the proposed approach to an individual loan could result in excess levels of reserves. For example, assume a company owns one A rated bond. Broad market statistics indicate that over the long term there are losses on A rated bonds. Thus the holder of an A rated bond has a reasonable basis to expect future losses. Applying these broad market statistics to a single bond (part of a hypothetical portfolio), however, would result in establishing reserves that are unlikely to reflect losses to be incurred. This result does not appear to improve financial reporting.

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Foreseeable Future vs. Life of Loan

Under the joint proposal, loss estimates are required for both the foreseeable future and the life of the loans. This distinction will affect the timing and amount of loss recognition because of the requirement that recorded reserves be at least sufficient to cover losses in the foreseeable future. However, we struggle with how this distinction will be implemented in practice. The inference in the joint proposal is that the foreseeable future is a shorter, more predictable period than the life of the loans. But if the Boards firmly believe that managements are capable of making reasonable, reliable estimates of expected losses for the life of the loans, what makes the foreseeable future more determinable? What criteria are used to determine “foreseeable future”? When would the periods be the same? How comparable will foreseeable future periods be among entities?⁷ What might cause companies to change their view as to the period that is foreseeable? While the proposal indicates that the foreseeable future is to remain fairly constant, it is not immutable. Further, if the company is using reliable data to estimate life of loan losses, why would the foreseeable future be more predictable than the term of the loans? We think practitioners will struggle with understanding and then making this distinction, with significant consequences to the amount of reserves recorded at any balance sheet date.

It would appear to us that an institution that is more sophisticated in its forecasting ability will record larger reserves than a less sophisticated institution that has more limited insight into expected market changes. This could be due to the somewhat elastic definition of foreseeable future or simply due to the institutions’ differing abilities to develop “reasonable and supportable information” in the normal course of operations. Does this make sense? Further, as economic conditions worsen, it becomes more difficult to anticipate near term developments and borrowers may delay repayment when loan terms permit, increasing average maturities. Both of these circumstances could lead to lower reserves during difficult economic times. Does this outcome make sense?

We also observe that “foreseeable future” is used in several other places in the accounting literature with very different meanings. Here are some instances from the US literature raising concerns about possible confusion and lack of consistency in implementing the proposal.

- Deferred taxes on foreign earnings.
- Intercompany loans to be repaid vs. net investment in a foreign investee.
- Definition of an “infrequent” item.
- Mortgage banking and loans not held for sale.
- Deferred tax assets related to outside basis differences in subsidiaries.

⁷ “’Tis with our judgments as our watches; none go just alike, yet each believes his own.” Alexander Pope (1688 – 1744)

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Forecasts for Various Periods (Foreseeable Future and Life of Loan)

We are concerned whether these forecasts of expected losses, both for the foreseeable future and for the life of the loans, are doable by all types and sizes of entities. Are the forecasts objective?⁸ Auditable? Comparable? Free from manipulation? Further, how does an entity, working in good faith, maintain a consistent degree of objectivity in its forecast methodologies over time? Wouldn't the natural tendency be to be somewhat more optimistic in boom periods and somewhat less optimistic when markets are weak? How does the "herd mentality" affect forecasting? Would an entity whose forecast differs from "the herd" be criticized for departing from the norm? On what basis? Who can say the forecast is wrong? Or right?

In this regard, it seems to us that the expected loss model is at least as judgmental and challenging as the incurred loss model. In fact, some would argue that forecasts of expected losses are even more prone to bias and inconsistencies across reporting entities than estimates of incurred losses.

Other Concerns

We have the following additional concerns about implementation:

1. In applying the proposal to revolving loans and credit card lines of credit, how do entities determine maturities to perform the time proportional calculations?
2. New systems—and the related internal controls over those systems—will be needed to develop time proportional losses in multiple portfolios. These challenges will be multiplied by the need to develop and maintain systems for the various "good books" for different portfolios, including systems to deal with the mechanics of spreading and periodic adjustments to deal with expected losses in the foreseeable future. And, of course, these new systems would be incremental to the maintenance of existing systems to maintain the incurred loss model for the "bad book" of loans.

Our Recommendations

As indicated earlier, we agree that the current accounting model for impairments of financial assets requires improvement. Two key, frequently cited concerns with the current model are (a) delayed recognition of losses and (b) inconsistencies and application challenges in practice. Standard setting is clearly needed to address these concerns.

In our view, the incurred loss model should be the basis for recognizing impairments. The concept is consistent with the conceptual framework and with a historical cost measurement. The concept is also understandable: recognizing a loss for something that has happened is an easy notion to grasp. It is consistent with the fundamental objective of historical financial statements: to communicate the effect that transactions and events occurring through a defined date have had on the financial position of the reporting entity. The principle of recording losses when they occur is similar to other areas of accounting. In addition, the incurred loss model can be applied to individual loans and securities as well as

⁸ "Hope springs eternal in the human breast: Man never is, but always to be blest." Alexander Pope (1688 – 1744)

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portfolios. The expected loss model, with its stated goal of recording losses before they occur, offers no improvement to financial reporting.

We acknowledge that it can be difficult to implement the incurred loss model, despite its clear concept.⁹ But we believe the standards setters should work to improve the incurred loss model, not give up on it. In our view, the current model is difficult to apply to financial assets because it is hard to know when a loss occurs, i.e., to identify the event or circumstance that caused the loss. Further, because the current standard for recognizing losses is tied to a conclusion that it is probable¹⁰ that the amounts will not be collected, practice has tended to wait until the loss is essentially confirmed before recognizing a loss, thus creating a bias toward understatement that is not a necessary by-product of an incurred loss model.

With respect to the criticism that the incurred loss model delays recognition of losses, we suggest the following:

1. We recommend lowering the threshold for loss recognition to “more likely than not,” as that term is used in US GAAP (“a likelihood of more than 50%”). Said differently, an impairment would be recognized when it is more likely than not that the remaining contractual cash flows will not be collected. The current threshold for recognizing losses, “probable will not collect,” is too high and creates a bias towards late recognition of losses that have, in fact, already occurred.
2. The standard should emphasize that loss recognition requires consideration of losses that have been incurred but not reported (IBNR) and should provide guidance on the factors to consider in developing estimates of IBNR.

We believe lowering the threshold for loss recognition combined with a clear articulation of an IBNR element in both the recognition and measurement of the impairment allowance will lead to more timely reporting of losses that have occurred.

The second issue related to the incurred loss model is that of diversity in practice. Our sense is that there currently is significant diversity with respect to quantifying the IBNR portion of the impairment allowance, perhaps because some are concerned about methodologies that seem to sweep in future events. We believe that the quantification of the IBNR portion of the impairment allowance necessarily incorporates forward looking information. In other words, we believe that under an incurred loss model, an entity's expectations about losses that will be specifically identified in the future should inform its analysis of what losses have been incurred, albeit not yet specifically identified, as of the reporting date. The use of a forward looking “emergence period” for estimating IBNR losses is wholly consistent with

⁹ If implementing the incurred loss model, with its clear concept, has been a challenge and has resulted in inconsistencies in practice, one can only imagine the difficulties that will be encountered with the Boards' joint proposal.

¹⁰ In the US, the word “probable” is defined as “likely to occur.” In practice, as evidenced by various academic studies, “probable” is interpreted to require a 75-80% probability of occurrence. In contrast, “more likely than not” represents a likelihood of more than 50%.

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an incurred loss model and we believe that diversity in practice could be reduced by an expanded discussion of the IBNR element in an impairment standard.¹¹

We believe our recommendations and the Boards' proposal related to assets in the "bad book" would produce substantially similar results. For assets in the "good book," while our recommendations may result in the recognition of impairment losses in a somewhat similar manner to the Boards' proposal,¹² our recommendation does not include a floor and therefore does not trigger an impairment on the day loans are originated or purchased.

We believe that many of the procedures and ideas (as well as the related research) developed in connection with the Boards' proposal could be used or modified to aid the development of practical approaches in quantifying the losses that have been incurred but not yet identified. But the stated objective would be to "recognize losses when they occur" vs. "recognize losses before they occur," as the proposal is currently framed.

In this same regard, recent discussions have revealed to us the diversity in views as to how an incurred loss model works. This diversity is inevitably affecting not only current financial reporting (and thus creating some of the problems with the existing model) but is also influencing views of constituents as to the way forward. It appears to us that some of this diversity stems from confusion about what qualifies as a loss event. Another contributor to this diversity arises from confusion between the recognition of a loss and its measurement. The joint proposal thus appears to have an "advantage" over the incurred loss model in that it requires no understanding of what constitutes a loss event because the "occurrence" of the loss does not drive recognition. Further, the joint proposal does not require clarity between recognition and measurement for assets in the "good book" since expectations of future cash flows are incorporated in both. However, in our view, these "advantages" do not improve financial reporting.

Opponents of the incurred loss model identify two additional problems with it in practice. First, it is asserted that an enterprise can manage earnings given the judgment required to determine when losses occur. We believe the same criticism can be made of the joint proposal. In fact, as we mention earlier in our letter, it may be even more difficult to evaluate the reasonableness of management's judgments about expected losses, much less the distinction between expected losses over the life of the loans and expected losses over the foreseeable future. Second, opponents of the incurred loss model assert that identifying the event of impairment is difficult. We agree. But we believe that specific challenge can be met by improving the guidance on the IBNR component of incurred losses as well as clarifying other areas. Ignoring the line between past and future events does not eliminate its existence but it does muddy the information being presented and mask the economic effect of current events.

¹¹ In this regard, we note that we would be supportive of an impairment model that effectively reserves for "losses in the foreseeable future" if the underlying concept were based on losses that have been incurred but not reported.

¹² If our recommendations were implemented, we would expect the principal difference between the impairment provision/impairment allowance for the "good book" under the Boards' proposal and the incurred loss model would be the portion of future expected losses that would be recognized under a combination of the "foreseeable future losses" under the "floor" and the mechanics of the amortization approach for "life of loan" expected losses. Logically, there would be no difference for IBNR losses.

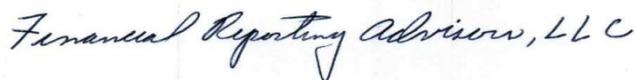
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In summary, we believe our recommendations:

- Address the criticisms of the current model and result in more timely recognition of impairment allowances.
- Report the economic consequences of changes in market conditions, deterioration in credit quality and other negative events that give rise to impairment losses in the periods those events occur.
- Are consistent with the conceptual framework and will preserve the necessarily sharp distinction between past and future events.
- Will not create confusion with respect to the application of ASC 450 to contingencies other than loan losses.
- Do not require entities to (a) distinguish between a “good book” and a “bad book,”¹³ (b) determine floor amounts for defined foreseeable future periods, or (c) make time proportional computations, all of which create complexity and operational challenges.
- Will not result in the recognition of an impairment loss on the day loans are originated or purchased.
- Can be applied to open portfolios, closed portfolios, individual loans/securities and trade receivables.

Once again we appreciate the opportunity to comment on the Supplementary Document, *Financial Instruments: Impairment*. If there are any questions, please contact John E. Stewart at 312-345-9104.

Sincerely,



Financial Reporting Advisors, LLC

¹³ Consistent with current practices, entities would certainly be permitted to have “good” and “bad” books or other stratifications if doing so is helpful to managing their credit risks and implementing the concepts of an incurred loss model including reserves for (a) specific loans and (b) IBNR.