CENTER FOR AUDIT QUALITY
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Technical Director
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Proposed amendments to the impairment and interest income measurement guidance of ETIF Issue No.99-20

File Reference: FSP EITF 99-20-a

Dear Mr. Golden:

The Center for Audit Quality (CAQ or the Center) is pleased to comment on the above mentioned proposed FASB Staff Position EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No.99-20* (the proposed FSP). The CAQ is an autonomous public policy organization serving investors, public company auditors and the capital markets and is affiliated with the American Institute of CPAs. The CAQ's mission is to foster confidence in the audit process and to aid investors and the markets by advancing constructive suggestions for change rooted in the profession's core values of integrity, objectivity, honesty and trust. Based in Washington, D.C., the CAQ consists of approximately 800 member firms that audit or are interested in auditing public companies.

The CAQ supports the efforts by the Financial Accounting Standards Board (FASB or the Board) to address accounting issues related to financial instruments, in particular the Board's efforts to achieve more consistent determination of whether an other-than-temporary impairment (OTTI) has occurred for debt securities classified as available-for-sale or held-to-maturity. While the proposed FSP is not the model set forth in the CAQ letter to the Securities and Exchange Commission (SEC or Commission) on November 13, 2008[1] related to the SEC's study on mark-to-market accounting (the

[1] See letter to Florence E. Harmon at - http://www.thecaq.org/newsroom/pdfs/CAQCommentLetter-FairValueFAS157.pdf

November 2008 Letter), we understand the Board's desire to consider such an approach as part of a longer-term comprehensive project to address the complexity in existing accounting standards for financial instruments, which will be undertaken jointly with the International Accounting Standards Board (IASB).

We strongly encourage the Board to expeditiously address issues related to the complexity of current accounting for financial instruments, including issues around impairment. In connection therewith, we also encourage the Board to further consider the recommendations of the CAQ set forth in our November 2008 Letter.

The CAQ supports the issuance of the proposed FSP, subject to the changes described below, and would encourage the Board to utilize the FSP as an intermediate step to potential improvements to accounting standards for investments in debt and equity securities. As stated in our November 2008 Letter, the CAQ continues to believe that the current use of fair value measurements for financial instruments in the financial statements should not be changed at this time; the definition of fair value and basic objectives of fair value measurements under FASB Statement No. 157, *Fair Value Measurements,* are appropriate; and neither currently required or permitted fair value measurements nor FASB Statement No. 157 should be suspended.

Specific Comments

<u>Amendments to EITF 99-20 ¶12</u>

The CAQ notes that the proposed amendments to the introduction to paragraph 12 would indicate that the Emerging Issues Task Force has reached a consensus on the proposed amended guidance in paragraphs 12 a. and 12 b. In fact, the EITF has not reached a consensus on any of the proposed amendments to EITF 99-20. While a FASB Staff Position (category (a) of the GAAP hierarchy) can amend an EITF Issue (category (c) of the GAAP hierarchy), we suggest that the amended introduction to paragraph 12 indicate that the paragraph has been amended by the proposed FSP.

In paragraph 12 a. the words "(or an adverse)" were struck out. We believe this phrase should remain because if the estimated cash flows increase (resulting in a higher yield), and then subsequently decrease (resulting in a lower yield), the yield should be adjusted downward. The decline (after the initial increase) may not result in an impairment because the fair value (or revised present value of the estimated cash flows) may continue to exceed the "reference amount," which is appropriately used in paragraph 12 b. to define when an impairment exists.

We also believe the proposed changes to paragraph 12 b. are not operational. The proposed FSP simply states an enterprise should determine whether a decline is other than temporary based on the guidance in paragraph 16 of Statement 115, which makes reference to whether it is probable the holder will not collect all amounts due according to the contractual terms of the security. For securitizations that have a contractual waterfall, the beneficial interests, by definition, always collect all amounts due according to the contractual terms. Therefore, an other-than-temporary impairment would never exist under a literal reading of Statement 115 for these debt securities. EITF Issue 99-20 was initially issued for this reason, among others.

To accomplish the FASB's goals, paragraph 12 of EITF 99-20 should be amended to (a) require the holder to update the estimated cash flows over the life of the beneficial interest, and (b) determine whether, based on current information and events, it is probable, as defined in FASB Statement No. 5, *Accounting for Contingencies*, that there has been an adverse change in the estimated cash flows as compared to the cash flows previously projected, and (c) recognize an other-than-temporary impairment when it is probable that an adverse change in estimated cash flows has occurred and the beneficial interest's reference amount exceeds its fair value. In other words, the existing EITF 99-20 methodology should be retained in its entirety, except that the cash flow definition would be changed so that it does not refer to market participants, but rather to the holder's estimate of the cash flows.

Accordingly, we believe that paragraph 12 should be amended to state:

12. The ~~Task Force reached~~ following ~~a~~ consensus was reached about the accounting subsequent to initial recognition depending on whether an evaluation indicates it is probable that estimated cash flows have changed favorably or adversely when compared to those previously projected (as amended by FASB Staff Position EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No.99-20)*~~that the holder of a beneficial interest should continue to update the estimate of cash flows over the life of the beneficial interest. If upon evaluation~~:

    a. If b~~B~~ased on current information and events, it is probable ~~that the holder of the beneficial interest estimates a market participant would use in determining the current fair value of the beneficial interest~~ there is a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected, then the investor should recalculate the amount of accretable yield for the beneficial interest on the date of evaluation as the excess of estimated cash flows over the beneficial interest's reference amount (the reference amount is equal to (1) the initial investment less (2) cash received to date less (3) other-than-temporary impairments recognized to date [as described in paragraph 12(b)]) plus (4) the yield accreted to date). The adjustment should be accounted for prospectively as a change in estimate in conformity with Opinion 20, with the amount of periodic accretion adjusted over the remaining life of the beneficial interest. Based on estimated cash flows, interest income may be recognized on a beneficial interest even if the net investment in the beneficial interest is accreted to an amount greater than the amount at which the beneficial interest could be settled if prepaid immediately in its entirety.

    b. If t~~T~~he fair value of the beneficial interest has declined below its reference amount, an enterprise should determine whether the decline is other-than-temporary. An entity should apply the impairment of securities guidance in paragraph 16 of Statement 115. If, based on current information and events, it is probable ~~a holder's best estimate of cash flows, that a market participant would use in determining the current fair value of the beneficial interest that~~ there has been an adverse change in estimated cash flows (in accordance with paragraph12(a) above), then the condition in paragraph 8(a) of

> Statement 5 is met and (1) an other-than-temporary impairment should be considered to have occurred and (2) the beneficial interest should be written down to fair value with the resulting change being included in income. Determining whether there has been a favorable (or an adverse) change in estimated cash flows from the cash flows previously projected (taking into consideration both the timing and amount of the estimated cash flows) involves comparing the present value of the remaining cash flows as estimated at the initial transaction date (or at the last date previously revised) against the present value of the cash flows estimated at the current financial reporting date. The cash flows should be discounted at a rate equal to the current yield used to accrete the beneficial interest. If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is less than the present value of the current estimated cash flows, the change is considered favorable (that is, an other-than-temporary impairment should be considered to have not occurred under the consensus in this Issue). If the present value of the original cash flows estimated at the initial transaction date (or the last date previously revised) is greater than the present value of the current estimated cash flows, the change is considered adverse (that is, an other-than temporary impairment should be considered to have occurred under the consensus in this Issue). However, absent any other factors that indicate an other-than-temporary impairment has occurred, changes in the interest rate of a "plain vanilla," variable-rate beneficial interest generally should not result in the recognition of an other-than-temporary impairment (see footnote 2, Exhibit 99-20A) (a plain-vanilla, variable-rate beneficial interest does not include those variable-rate beneficial interests with interest rate reset formulas that involve either leverage or an inverse floater).

<u>Scope of EITF 99-20</u>

Paragraph 5(a) of the "Background" section of the proposed FSP includes an example using a noninvestment grade beneficial interest. We are concerned that some may misconstrue the example as an indication that the Board intends to change the scope of the beneficial interests to which EITF 99-20 applies (i.e., what instruments are considered not of high credit quality), accordingly, we suggest amending the last sentence in this paragraph to read: "For example, a beneficial interest within the scope of Issue 99-20 would apply the Issue 99-20 impairment model while a corporate bond with the same credit rating would apply the Statement 115 impairment model."

Paragraph 5(b) of the "Background" section of the proposed FSP clarifies that "…entities are not required to reassess whether a beneficial interest is within the scope of Issue 99-20." Although the determination of whether a security is within the scope of EITF 99-20 is generally determined at a security's acquisition date, we understand that companies have interpreted the issue of when to evaluate whether an instrument falls within the scope of EITF 99-20 differently and have developed accounting policies on the application of EITF 99-20 subsequent to acquisition (i.e., one-time assessment at acquisition only, assessment at acquisition and in connection with other-than-temporary impairments, or continual assessment). If the Board intends to address the issue of reassessing whether debt securities are within the scope of EITF 99-20 subsequent to acquisition, we suggest that this clarification be included in the amendment to EITF Issue 99-20 included in the Appendix to the proposed FSP and not just in the Background section of the proposed FSP, which will not be included in the Codification. If such guidance is provided, we also believe the Board should provide specific guidance as to the effective date and transition for this provision.

Effective Date and Transition

Paragraph 10 indicates that the proposed FSP shall be effective for interim and annual reporting periods ending after December 15, 2008, and shall be applied prospectively. That statement, along with the reference to paragraph 15 of FSP FAS 115-1/124-1 makes clear that any impairment resulting from the application of the proposed FSP shall be recognized in earnings equal to the difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made (for example, December 31, 2008, for a calendar year-end entity). So as to avoid any confusion as to whether the proposed FSP would allow a reporting entity to reverse previously reported other-than-temporary impairment charges recognized under the current version of EITF 99-20, compared to what those impairment charges would have been, if any, under the proposed FSP, we suggest that a sentence be added explicitly stating that retrospective application of the FSP is prohibited.

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We would be pleased to discuss our comments with the Board or the FASB Staff at your convenience.

Very truly yours,

Cynthia M. Fornelli

Cynthia M. Fornelli
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Center for Audit Quality