



**Richard D. Levy**  
Executive Vice President & Controller

MAC A0163-039  
343 Sansome Street, 3rd Floor  
San Francisco, CA 94104  
415 222-3119  
415 975-6871 Fax  
richard.d.levy@wellsfargo.com

June 28, 2013

Via electronic mail

Susan M. Cospers, Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
PO Box 5116  
Norwalk, Connecticut 06856-5116

**Re: File Reference No. EITF – 13B: Proposed Accounting Standards Update of Topic 323,  
*Accounting for Investments in Qualified Affordable Housing Projects***

Dear Ms. Cospers:

Wells Fargo & Company (Wells Fargo) is a diversified financial services company with over \$1.4 trillion in assets providing banking, insurance, trust and investments, mortgage banking, investment banking, retail banking, and consumer finance services. We appreciate the opportunity to comment on the exposure draft, Proposed Accounting Standards Update of Topic 323, *Accounting for Investments in Qualified Affordable Housing Projects* (the “Proposed ASU”).

#### **Executive Summary**

Wells Fargo is a significant investor in low income housing tax credit (LIHTC) investments as well as other tax credit investments (e.g. wind energy, solar, new market tax credits). We make tax credit investments to meet our Community Reinvestment Act requirements and to lower our effective tax rate. We support the expansion of the use of the effective yield method to account for LIHTC investments and believe this method should be available for other similar types of tax credit investments. We believe this can be accomplished by leveraging the proposed criteria in a more principled manner.

The Proposed ASU amends the eligibility criteria to allow greater use of the effective yield method for LIHTC investments. Other accounting methods for tax credit investments include the equity and cost methods. One of the primary differences between the effective yield method and the cost / equity methods is classification in the income statement. Under the effective yield method, investment earnings are recorded entirely in income tax expense. Under the cost / equity method, an income statement “gross-up” occurs, as amortization of the investment is reflected in pre-tax earnings resulting in a pre-tax loss and the tax benefits (which represent substantially all of the return of and on the investment) reflected as a reduction of income tax expense. Accordingly, we believe it is appropriate to reflect the income statement impacts of qualified tax credit investments within income taxes, regardless of accounting method applied, because this better aligns financial reporting with the nature of the investment and prevents pre-tax / after-tax distortion of the investor’s operating results. In addition to the difference in the income statement classification, the Proposed ASU changes the how the effective yield is determined and applied. The effective yield used in the Proposed ASU considers returns derived from all tax benefits

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associated with the investment whereas current guidance only includes tax credits. We agree with this change as it aligns with the revised criteria to qualify for the effective yield method. However, we do have concerns regarding the effective yield application guidance in the Proposed ASU. We believe clarification is warranted given the significant expansion of this method in practice that is likely to occur upon finalization.

### **Specific Comments on FASB Proposal**

We have the following additional comments for the FASB to consider:

- Including all of the income statement impacts of all types of tax credit investments within income tax expense provides more meaningful financial reporting: Because investors in tax credit investments expect to receive substantially all of their return via tax credits and other tax benefits, rather than through cash flows of the underlying assets, investment performance is evaluated on an after-tax basis. Accordingly, we believe it would be more meaningful to present these returns as an adjustment to income tax expense regardless of how the investment is amortized. The current accounting methods for tax credit investments, other than the effective yield method, distort the measurement of operating performance and may adversely affect the ability of some banks to invest in tax credit structures because of the negative impact to pre-tax earnings.

We do not believe LIHTC investments are unique relative to other types of tax credit investments in the marketplace today and thus would be supportive of a principles based standard, which could be applied consistently to all tax credit structures with similar characteristics. Creating a principle based approach will provide consistent financial reporting for transactions which have a similar investment profile. Other tax credit structure types may have a different mix of income attributes (cash income, tax credits, other tax benefits), which may make those investments ineligible for the effective yield method; however, we believe the criteria, as defined in the Proposed ASU, could be applied on a principle basis to other tax credit structures by simply not making the criteria specific to LIHTC investments.

- Additional clarity is needed on application of the effective yield method: The Proposed ASU does not consider certain complexities common to applying the effective yield method.
  - *Day 2 changes in expected cash flows:* The Proposed ASU does not address how to account for changes in expected tax benefits subsequent to initial recognition. The effective yield is calculated at inception based upon the timing and amount of expected tax benefits, which includes the investor's share of tax credits and deductible net operating losses, over the life of the investment. Subsequent to initial recognition, the timing and amount of these benefits may vary from initial projections. While the expected tax credits are typically reliably estimable, the amount of net operating losses may vary due to changes in operating expenses and/ or occupancy rates. This variability makes the cash flows associated with tax credit investments even less predictable than many types of debt investments and necessitates additional clarity regarding the accounting for changes in expected cash flows. Accordingly, the Board should clarify whether the effective yield should be held constant or periodically evaluated and adjusted (either retroactively or prospectively, if necessary) to reflect revised projections and accounting for the resulting adjustment. We recommend the final ASU include application guidance to address this issue, including its interaction with the impairment assessment and measurement.

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- *The assessment and measurement of impairment requires clarification:* The example provided in the Proposed ASU is flawed as it does not fully contemplate all of the expected tax benefits. Accordingly, the example assumes impairment even though the investment performs as expected. We do not believe impairment should be recognized when an investment performs as expected. To clarify the guidance, we believe impairment should be assessed and measured based on all remaining expected tax benefits and cash flows, if applicable. This would align the impairment assessment with the determination of the effective yield which considers all expected tax benefits.

In addition, we encourage the Board to clarify the measurement method for impairment. If it is the intention of the Board to assess impairment based on the present value of expected tax benefits, the Board should clarify whether impairment should be measured based on the present value of remaining expected tax benefits discounted at the original effective yield or based on a recast of the expected tax benefits from the inception of the investment. If it is the intention of the Board to assess impairment based on undiscounted remaining tax benefits, the Board should clarify when a prospective adjustment in the effective yield is appropriate. Alternatively, the Board could consider carrying forward the footnote in the equity method example, which explains that multiple methods of assessing and measuring impairment are acceptable. Given the complexities that may arise in applying the effective yield method to tax credit investments, ensuring consistency between the example and the guidance is essential.

- *Negative amortization of investment:* LIHTC investments are often made during the construction phase of a property development project and the tax credits are not received until construction is completed and property is operational. This may result in a 1 to 2 year period subsequent to the investment before the investor receives its initial tax credit allocation. When applying the effective yield method in this scenario, an investor may be required to write up the investment balance to achieve the required after-tax return. It is not clear if this is appropriate and final guidance should address income recognition in this scenario.
- A scope exception from the proposed classification and measurement guidance is necessary: Absent a scope exception, we believe fair value accounting would be required under the Proposed Accounting Standards Update, *Financial Instruments-Overall (Subtopic 825-10), Recognition and Measurement of Financial Assets and Liabilities*. The proposed requirement to consider an equity method investment as held for sale if an identified potential exit strategy and associated exit time-line exists is too broad. Many tax credit investments could be considered held for sale given the likelihood of disposition of the investment after the tax credits have been received. We believe this change should be addressed in the re-deliberations of the proposed classification and measurement guidance.
- Retrospective application with a cumulative adjustment to retained earnings in the period of adoption should be permitted: Because of the change to the timing and geography of income recognition under the effective yield method, we agree retrospective application will provide the most comparable information; however, we believe preparers should be provided the option to recognize a cumulative effect adjustment in the period of adoption based on materiality. Such an approach would provide consistent treatment for the current investment portfolio and alleviate the operational burden of applying the full retrospective method for all periods presented.

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**Conclusion**

We support the Board's proposed modification to allow for greater use of the effective yield method of accounting, specifically, including the impacts associated with qualifying tax credit investments within income tax expense. We believe this guidance should be applied in a principled manner to similar tax credit investments to provide consistent and improved financial reporting. Clarification is needed regarding the assessment and measurement of impairment and income recognition for such investments.

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We appreciate the opportunity to comment on the issues contained in the proposed guidance. If you have any questions, please contact me at 415-222-3119.

Sincerely,

/s/ Richard D. Levy

Richard D. Levy  
Executive Vice President & Controller