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FASB Proposed Accounting Standards Update: Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Financial Instruments (Topic 815) & Derivatives and Hedging (Topic 825)

The Accounting Principles and Auditing Standards Committee of the Florida Institute of Certified Public Accountants (the "Committee") has reviewed and discussed the above Proposed Accounting Standards Update (the "Update"). We appreciate the opportunity to respond to the Update. Our comments are outlined below. These comments specifically relate to the Questions for Respondents and an additional comment on a specific question's topic.

Scope

- 1. Yes, the Committee agrees with the scope of financial instruments included in the proposed Update.
- 2. Yes, the Committee agrees that the loan commitments related to a revolving line of credit issued under a credit card arrangement should be excluded from the scope of this proposed Update.
- 3. Yes, we agree that the proposed Update should include deposit-type and investment contracts of insurance and other entities to be measured at fair value.
- 4. Yes, we agree with the proposed change to the criteria for the equity method of accounting.
- 5. to 7.

We have chosen not to respond to the "questions for users."

Initial Measurement

- 8. Yes, the Committee agrees with the initial measurement principles for financial instruments as outlined in the proposed guidance.
- 9. Yes, we agree that such significant differences are most appropriately recognized in net income.

- 10. No, we believe the multiple initial measurement principles as outlined in the proposed Update are appropriate for financial assets and liabilities, with differences in initial measurement based on the treatment of subsequent changes in value.
- 11. Yes, we agree with the language in the proposed Update regarding transaction fees and costs.
- 12. Yes, the proposed guidance appears operational in determining situations where there are significant differences between the transaction price and fair value.

Subsequent Measurement

- 13. Yes, the Committee believes the default measurement attribute for financial instruments should be fair value in all cases. However, we also tend to agree with those certain Board members who believe fair value of financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows can lead to confusing variations in other comprehensive income related to market changes in the fair value of the related financial asset or liability when the entity has no intention to realize such changes in fair value.
- 14. No, we do not believe that any other fair value changes should be recognized in net income for the financial instruments described in Question 14.
- 15. Subject to the qualifying financial liabilities listed as exceptions to the subsequent measurement principle in the proposed Update, yes, we agree that subsequent measurement principles should be the same for financial assets and financial liabilities.
- 16. Yes, we agree that reclassifications between categories should be prohibited, and agree with the background information and basis for conclusions outlined in paragraph BC105.
- 17. Yes, we believe that the re-measurement approached described in this question is appropriate. We also agree that the re-measurement amount should be disclosed in the notes to the financial statements rather than presented on the face of the financial statements to avoid confusion to the reader.
- 18. Yes, we agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria outlined in Question 18.
- 19. Yes, we believe that the correct financial instruments are captured by the criteria in the proposed guidance for measurement at their redemption amount.
- 20. Yes, we agree with the proposed guidance regarding valuations allowances on deferred tax assets.
- 21. Yes, we agree with the Board's proposed guidance on the application of fair value accounting to convertible debt obligations.
- 22. to 27.

 We have chosen not to respond to these "questions for users."
- 28. Yes, the Committee believes the proposed criteria for recognizing qualifying changes in fair value in other comprehensive income are operational.
- 29. Yes, we believe that the measurement of financial liabilities at fair value is operational.

- 30. Yes, we believe the proposed criteria are operational regarding measuring a financial liability at amortized cost instead of at fair value.
- 31. We believe that the re-measurement approach described is operational and clearly defined.

Presentation

- 32. The Committee believes that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which is consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option, as opposed to separating the disclosure into net income and a comprehensive income components. For nonpublic companies or other entities without a clear credit quality rating, it will be operationally difficult to determine the portion of a change in fair value attributed to changes in credit standing. We do not believe such additional recordkeeping and reporting complexities are outweighed by the Board's desire to address the differing needs of different financial statement users, nor do we believe that such separate disclosures will be reliable enough to warrant the additional burden to financial statement preparers and auditors.
- 33. The clear strength of Method 1 as shown in Appendix B is its simplicity; for those entities rated by widely recognized credit rating agencies, a simple verification that the entity's credit quality rating has not changed would eliminate the need for further work to determine what portion, if any, of a change in fair value relates to changes in the credit standing of the entity. On the other hand, the clear strength of Method 2 is its consistency; all entities would be required to analyze changes in the fair values of financial liabilities under the same method, which should, theoretically, improve the comparability and consistency of financial statements. We believe it would be better for all entities to use Method 2 to ensure consistency in the application of the proposed guidance, even though we believe the use of Method 2 adds significant variability in the calculation of changes in fair value attributed to credit quality changes due to the operational difficulties many entities will face in bifurcating the change in the fair value of their financial liabilities.
- 34. For nonpublic companies or other entities without comparably-sized, same-industry competitors (or entities without access to publicly-available information about the credit qualities or cost of capital of like-sized and -purposed entities), we do not believe the proposed guidance in Appendix B is operational. In our view, the guidance should not be as constrictive as proposed; if the most relevant or reliable information is from all entities in the market of a similar size, or from all entities in the industry of a similar size, or from some other population, then we believe the use of such more relevant and/or reliable information should be used in determining the change in fair value of a financial liability attributable to a change in an entity's credit standing.
- 35. to 36.

We have chosen not to respond to these "questions for users."

Credit Impairment

- 37. Yes, the Committee believes the objective of the credit impairment model in the proposed Update is clear.
- 38. We concur with the Board's proposed guidance regarding the recognition of a credit impairment immediately in net income when an entity does not expect to collect all contractual amounts due (for originated financial assets) and/or all amounts originally expected to be collected (for purchased financial assets). We do not agree with the proposed framework contained in the IASB Exposure Draft on Impairment.

- 39. Yes, we agree that a credit impairment should not, by default, result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, expected prepayments, or variable interest rates.
- 40. No, we agree with the proposed guidance that a particular methodology does not need to be applied by individual entities for determining historical loss rates.
- 41. Yes, as it relates to purchased financial assets, we agree that change in future expected cash flows should be recognized as an adjustment to the effective interest rate as additional interest income rather than as an immediate gain in net income. For assets written down as a result of credit impairments, we agree with the Board conclusions in paragraph BC195 regarding reversal of credit impairment allowances.
- 42. Yes, we agree with the proposed guidance requiring an entity to determine whether assessing a financial asset without an individual credit impairment along with other similar financial assets to determine if a credit impairment exists for the group results in a credit impairment, and that such credit impairment would be measured by applying the historical loss rate applicable to the group of similar financial assets to the individual financial asset to determine the amount, if any, of credit impairment to be recorded.
- 43. *to* 45. We have chosen not to respond to these "questions for users."
- 46. We have a difficult time determining which method (the Board's proposed guidance requiring only those facts existing at the balance sheet date or the IASB's proposal wherein a probability-weighted analysis is performed in determining whether a credit impairment exists) is more appropriate. Regarding the Board's proposal, we note that true fair value would be reflected if only that data known at the balance sheet is considered in determining potential credit impairments. As to the IASB proposal, we note that significant variability could be substantially reduced if a probability-weighted analysis is performed and subsequent changes in fair value can be incorporated. However, given the Board's intent to transition to true fair value accounting, it would seem inappropriate to incorporate a probability-weighted analysis using any future data in the determination of fair value as of a particular date. Regardless, both methods appear operational.
- 47. No, we do not believe the approach to determining appropriate historical loss rates as outlined in the proposed guidance would not result in a significant change in practice.

Interest Income

- 48. The Committee believes that the recognition of interest income should be affected by the recognition or reversal of credit impairments.
- 49. We agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses
- 50. We believe that the interest income recognition guidance should be the same for all financial assets.

- 51. The guidance and illustrative examples included in this proposed Update are sufficient to understand the proposed credit impairment and interest income models.
- 52. to 55.

We have chosen not to respond to these questions "questions for users."

Hedge Accounting

- 56. Yes, the Committee believes it is appropriate to modify the effectiveness threshold from *highly effective* to *reasonably effective* for hedge accounting. We believe this proposal is suitable due to the complex and occasionally burdensome accounting requirements inherent in the currently required quantitative assessment of effectiveness that could, in some instances under the proposed guidance, be shortened or eliminated if the entity concludes that a suitable qualitative assessment is appropriate.
- 57. No, we believe it is appropriate for the guidance to require periodic effectiveness evaluations for hedging relationships subsequent to inception. Such periodic evaluations, as suggested by the background information and basis for conclusions presented by the Board, may be made only when there is a change in circumstances or events leading an entity to believe the effectiveness of its hedging relationship should be re-evaluated; regardless, we do not find it appropriate to completely eliminate the requirement for subsequent evaluations of hedging effectiveness due to the differences in accounting for effective an ineffective hedges. In the event that a mismatch of financial assets and liabilities exists as it relates to the hedge relationship, the hedge accounting should reflect the ineffectiveness of the related hedge.
- 58. Yes, we agree that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued. By permitting entities to apply some degree of judgment (rather than the current requirement of a strict, quantitative effectiveness calculation), there would be circumstances wherein an entity's hedging relationship would not be deemed reasonably effective for one period when the intent of the entity is to continue the hedging relationship and make it reasonably effective again. As noted in the Board's background information and basis for conclusions, this would improve the consistency of reporting and disclosures of hedging relationships and make financial statement use and analysis more meaningful.
- 59. *to* 60.

We have chosen not to respond to these "questions for users."

- 61. The Committee expects the proposed guidance regarding calculating ineffectiveness for cash flow hedging relationships to be as operational as the guidance being replaced.
- 62. No, we do not foresee any significant operational concerns or constraints regarding creating processes that will determine when changed in circumstances suggest that a hedging relationship may no longer be reasonably effective (without requiring reassessment of the hedge effectiveness at each reporting period). We believe the proposed guidance is appropriate.
- 63. No, we do not foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply de-designating the hedging relationship. We believe the proposed guidance is appropriate.
- 64. We do not foresee any significant operational concerns or constraints regarding effective terminations of hedging derivative attributes.

Disclosures

65. The Committee agrees with the proposed disclosure requirements.

66. to 67.

We have chosen not to respond to these "questions for users."

Effective Date and Transition

- 68. The Committee agrees with the transition provision in this proposed Update.
- 69. Yes, we agree with the proposed delayed effective date for certain aspects of the proposed Update for nonpublic entities with less than \$1 billion in total consolidated assets.
- 70. We believe the proposed guidance should be effective no sooner than fiscal years ending in December 2012.
- 71. We believe the proposed transition provision is operational.

The above responses reflect the committee's views as to the specific questions asked to respond. However, we have the following comment with regard to the criteria for the delay provisions for nonpublic entities and believe that the FASB should consider the following.

- 1. There are a significant number of small-cap (those under \$75M) public companies that these proposed standards would apply. We would therefore suggest that small cap companies be included in the delay provisions.
- 2. The criteria for non-public entities should define for how long a period that entity hits the \$1 billion mark that it would be required to comply with the standard as well as to what happens if the entity's assets fall below that amount.

Again, the Committee appreciates this opportunity to share its views and comments on the Draft. Members of the Committee are available to discuss any questions you may have regarding this communication.

Sincerely,

Steven Wm. Bierbrunner, CPA Chair FICPA Accounting Principles and Auditing Standards Committee

Committee Members Coordinating this Response: Michael Heald, CPA Julian Dozier, CPA Laura Prevratil, CPA