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September 13, 2010

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, Connecticut 06856-5116

Re: File Reference No. 1810-100: Proposed Accounting Standards Update, "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities – Topics 825 and 815"

The Accounting and Auditing Committee (the "Committee") of the Pennsylvania Institute of CPAs ("PICPA") appreciates the opportunity to comment on the Proposed Accounting Standards Update on Accounting for Financial Instruments. We share the Board's objective to develop an improved and consistent financial reporting model for the recognition, measurement, and presentation of financial instruments in an entity's financial statements. While this proposed ASU is a step in this direction, we believe the proposed standards need improvement.

In general we are disappointed in the following three areas:

1. The lack of convergence between this proposal and IASB's IFRS 9 and the IASB exposure draft *Fair Value Option for Financial Liabilities*.

2. The default model for financial instruments is a fair value model but there are many exceptions to this approach making the proposed financial reporting model inconsistent with the Board's objective.

3. The FASB Board has stated numerous times that one of its standard setting goals is to reduce the complexity associated with generally accepted accounting principles. Unfortunately, this proposed ASU introduces more complexity than exists today in ASC Topic 825. While there are many examples of this complexity, paragraphs 14 to 17 are particularly significant.

The Committee's specific comments are organized in the following topic areas:

- Classification and Measurement of Financial Assets and Financial Liabilities
- Credit Impairments
- Interest Income
- Hedge Accounting
- Equity Method Model
- Implementation Obstacles

Classification and Measurement of Financial Assets and Financial Liabilities

The Committee does not support the classification and measurement approach in this proposed ASU. The proposed ASU includes six categories of potential financial assets and financial liabilities:

1. Fair value through net income
2. Fair value through other comprehensive income
3. Amortized cost
4. Redemption value
5. Remeasurement approach for core deposits through net income
6. Remeasurement approach for core deposits through other comprehensive income

We believe this approach adds unnecessary complexity to financial instrument accounting and will be of little value to users. To simplify this approach, we recommend a mixed attribute model having only two classification and measurement options – fair value and amortized cost. We believe financial assets should be measured at fair value with changes in fair value recognized in other comprehensive income and financial liabilities should be measured at amortized cost based on the amount of expected cash payments to be made.

We further believe that requiring financial liabilities to be classified and measured at fair value provides an inconsistent presentation outcome when the fair value of a liability decreases (normally due to some financial difficulty or increase in credit risk) and a gain is recognized in the financial statements. This is intuitively inconsistent and conceptually incorrect.

While the Committee supports a fair value approach for financial assets, some consideration must be provided for privately held entities that have investments in other privately held entities that are not required to be consolidated. It will be impractable, in many situations to determine fair value due to their inability to obtain the relevant information for valuation purposes at a reasonable cost. We recommend that an exception be incorporated into the final standard that exempts privately held entities from having to fair value investments that do not actively trade and that these investments be accounted for at cost.

Credit Impairment

The Committee agrees with the FASB Board that the current credit impairment model (temporary, other than temporary, permanent) is unnecessarily complex and often inconsistently applied. The proposed impairment model creates more complexity due to its lack of a minimum threshold for loss estimates, probability approach, and the need to continually re-estimate the impairment losses.

Consistent with our recommendation that all financial assets be classified and measured at fair value (except for investments that do not actively trade) the Committee believes that credit impairment will necessarily be part of the fair value model and separate credit impairment guidance is not necessary. We do believe that additional disclosure should be required concerning the inputs into the fair value outcomes specifically as it relates to the nature of any changes in expected cash collections or increased non-performance or liquidity risk associated with financial assets.

Interest Income

The Committee finds the proposed guidance in paragraphs 75 through 82 confusing and unnecessary. Calculating interest income using a credit loss adjusted amortized cost balance as opposed to an effective interest model applied to the amortized cost balance appears to the Committee to be creating unnecessary complexity in this area. Further, the Committee is not clear how this approach can be applied in today's accounting systems since the proposed interest income model does not exist in today's general ledger systems.

Hedge Accounting

The Committee supports the proposed model for hedge accounting. We further support replacing "highly effective" with "reasonably effective" for hedge effectiveness purposes. We urge the Board though to more clearly define "reasonably effective" and provide guidelines or criteria as to the type of evidence that would be necessary for a hedging relationship to be "reasonably effective".

The Committee is unclear as to why the proposed ASU in paragraph 119 prohibits de-designations of hedging relationships. No member of the Committee has experienced problems or abuse in this area and understands that as business circumstances change it might be appropriate to de-designative a hedging relationship. If this prohibition continues in the final ASU, the Committee recommends that the FASB Board provide some rationale for its prohibition.

Equity Method Model

The Committee believes the elimination of the equity method of accounting is desirable. The current equity method model, when a reporting entity has significant influence, is flawed because the resulting accounting outcome is not based on logical accounting theory but simply an accounting outcome that adds and subtracts. Combining different purchasing powers and accounting bases (cost, share of investee income or loss, cash dividends, and goodwill impairment losses) is equivalent to adding and subtracting apples and oranges.

Instead of requiring these investments to be at fair value (except for investments that do not actively trade) the proposed ASU creates an additional requirement for use of the equity method in paragraph 130 stating "An investor shall apply the equity method of accounting only if the investor has significant influence over the investee and *if the operations of the investee are considered related to the investor's consolidated operations*". The paragraph further states "if only one of the two criteria is met, the investor shall account for the investment in the equity security at fair value with all changes in fair value recognized in net income". The Committee believes that all equity method investments that are not subject to consolidation should be accounted for at fair value except for equity investments that do not trade.

Implementation Obstacles

During the Committee's discussions of the proposed ASU, it became clear that a number of obstacles exist related to the implementation of this new guidance. Obstacles include:

- The development of new computer systems to accommodate the proposed guidance
- Training of entity accounting personnel as well as training of their auditors
- The development of new internal controls and internal control systems to accommodate the proposed guidance
- Education of users
- Revision of performance metrics to properly evaluate results
- Improved valuation models

While the Committee is sure the FASB Board has considered these implementation obstacles, a simplified financial instrument model with less complexity and consistent with IFRS guidance would minimize the obstacles noted above.

We appreciate your consideration of our comments. We are available to discuss any of these comments with you at your convenience.

Sincerely,

Richard E. Wortmann, CPA
Chairman, PICPA A&A Committee