

September 27, 2010

Technical Director
File Reference No. 1810-100
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5446

Re: Proposed Accounting Standards Update — Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities — Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)

Dear Director:

The Virginia Society of CPAs (VSCPA) Accounting and Auditing Advisory Committee has reviewed and discussed the above-referenced Proposed Accounting Standards Update. In general, the Committee supports the Financial Accounting Standards Board's (FASB) efforts to create a comprehensive framework for the recognition and measurement of financial instruments. However, the Committee also encourages the FASB and International Accounting Standards Board (IASB) to take efforts to reconcile their differences before issuing final guidance.

The Committee has the following specific comments related to select questions as outlined in the "Questions for All Respondents" section of the proposal:

Question 4: The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?

Response: No. The Committee believes that the requirement to have significant influence over the operations of the investee is sufficient to qualify for the equity method. Adding a requirement to evaluate the relationship of operations is unnecessary.

Question 9: For financial instruments for which qualifying changes in fair value are recognized in other comprehensive income, do you agree that a significant difference between the transaction price and the fair value on the transaction date should be recognized in net income if the significant difference relates to something other than fees or costs or because the market in which the transaction occurs is different from the market in which the reporting entity would transact? If not, why?

Response: Yes. The Committee believes it is appropriate to measure the difference in net income rather than Other Comprehensive Income (OCI) if there would otherwise be a significant departure from fair value. However, we also think that there should be no day one gain for instruments qualifying for future changes in fair value through OCI because the intent is to hold for collection of future cash flows. On the other hand, it would be appropriate to recognize a day one loss when an entity purchases a financial instrument at too high a price and determines that the purchase price was significantly higher than fair value. The Committee therefore supports the application of an asymmetrical model in which no day one gain could ever be recognized, but a day one loss would be recognized through net income when appropriate.

Question 10: Do you believe that there should be a single initial measurement principle regardless of whether changes in fair value of a financial instrument are recognized in net income or other comprehensive income? If yes, should that principle require initial measurement at the transaction price or fair value? Why?

Response: The Committee recommends that the proposed standard be worded differently and state that the measurement attribute be fair value for all financial instruments but as a practical expedient, instruments qualifying for subsequent treatment thru OCI can be initially recognized at the transaction price unless there is a significant difference between transaction price and fair value. The Committee believes that the asymmetrical model is appropriate when only a day one loss can be recognized, not a day one gain. Application of the "significant difference" standard should ensure that an instrument will be represented accurately without the administrative burden of determining smaller, less significant differences.

Question 11: Do you agree that transaction fees and costs should be (1) expensed immediately for financial instruments measured at fair value with all changes in fair value recognized in net income and (2) deferred and amortized as an adjustment of the yield for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income? If not, why?

Response: Yes. The Committee believes that the deferral of costs for financial instruments measured at fair value with qualifying changes in fair value recognized in OCI better represents the business purpose of the entity to hold for collection of contractual cash flows.

Question 13: The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

Response: Yes. The Committee believes the default measurement attribute for financial instruments should be fair value, as fair value generally presents more relevant information regarding the financial condition of an entity. Presentation on the balance sheet of the amortized cost with reconciliation to the fair value measurement provides useful information for users of financial statements, including regulators. The Committee suggests that the implementation guidance provide an example of the proposed balance sheet presentation.

Question 16: The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

Response: No. The Committee believes that reclassification should be required when an entity no longer has the intent or ability to hold instruments for a significant portion of their contractual terms due to changes in business strategy or liquidity constraints.

Question 32: For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe 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 would be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?

Response: The Committee believes recognition of the change in an entity's credit standing in OCI is more appropriate due to the inverse relationship to the entity's credit standing and the directional impact on the fair value of financial liabilities.

Question 38: The proposed guidance would require an entity to recognize a credit impairment immediately in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s).

The IASB Exposure Draft, Financial Instruments: Amortised Cost and Impairment (Exposure Draft on impairment), would require an entity to forecast credit losses upon acquisition and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using the effective interest rate method. Thus, initially expected credit losses would be recorded over the life of the financial asset as a reduction in interest income. If an entity revises its estimate of cash flows, the entity would adjust the carrying amount (amortized cost) of the financial asset and immediately recognize the amount of the adjustment in net income as an impairment gain or loss.

Do you believe that an entity should immediately recognize a credit impairment in net income when an entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

Response: The Committee prefers the IASB approach. If an entity originates or purchases a financial asset with the expectation that a portion of future cash inflows will go uncollected, it should be considered an implicit decrease in that investment's yield and thus factored into the effective interest rate. For example, for loan pools, it is expected at underwriting that some loans will result in future losses. Impairment losses could then be recognized via a provision/allowance to the extent that the life of loan losses exceeds those initially expected. Improvements from the amount of losses initially expected could result in an increased go-forward yield.

Question 39: Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?

Response: Yes. The Committee agrees that changes in those items are not necessarily indicative of a credit impairment. The proposed guidance states that if an entity cannot differentiate between the causes for an expected decline in cash flows, the entity would recognize all of the loss as a credit impairment.

Question 41: Do you agree that if an entity subsequently expects to collect more cash flows than originally expected to be collected for a purchased financial asset, the entity should recognize no immediate gain in net income but should adjust the effective interest rate so that the additional cash flows are recognized as an increase in interest income over the remaining life of the financial asset? If not, why?

Response: Yes. The Committee believes that entities should reverse the allowance for uncollectible accounts up to the amortized cost basis and then adjust the prospective yield.

Question 43: The credit impairment model in this proposed Update would remove the probable threshold. Thus, an entity would no longer wait until a credit loss is probable to recognize a credit impairment. An entity would be required to recognize a credit impairment immediately in net income when an entity does not expect to collect all of the contractual cash flows (or, for purchased financial assets, the amount originally expected). This will result in credit impairments being recognized earlier than they are under existing U.S. GAAP. Do you believe that removing the probable threshold so that credit impairments are recognized earlier provides more decision-useful information?

Response: Yes. The Committee supports the revised threshold for recognition of credit impairments. Relevant financial information would be reported in a more timely manner under this approach. Since assessments of impairments are no longer a one-way downward adjustment, there should be less reluctance for entities to write down the value of their investments when there are early indications that it would be appropriate to do so. We believe that moving credit reserves towards a fair value "expected" cash flow approach is critically important to restoring integrity to the overall financial instrument accounting model.

Question 44: The proposed guidance would require that in determining whether a credit impairment exists, an entity consider all available information relating to past events and existing conditions and their implications for the collectability of the cash flows attributable to the financial asset(s) at the date of the financial statements. An entity would assume that the economic conditions existing at the end of the reporting period would remain unchanged for the remaining life of the financial asset(s) and would not forecast future events or economic conditions that did not exist at the reporting date. In contrast, the IASB Exposure Draft on impairment proposes an expected loss approach and would require an entity to estimate credit losses on the basis of probability-weighted possible outcomes.

Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would provide more decision-useful information?

Response: The Committee disagrees with FASB's proposed approach that an entity must assume that economic conditions would remain unchanged going forward from the balance sheet date. The Committee prefers the IASB's weighted probability approach since it would be a more realistic approach to determining whether a credit impairment exists, noting that an entity's expectations of the future would be somewhat affected by the economic situations existing at the time of the evaluation. The Committee firmly believes that impairment should be measured based on a best estimate life of instrument approach.

Question 45: The proposed guidance would require that an appropriate historical loss rate (adjusted for existing economic factors and conditions) be determined for each individual pool of similar financial assets. Historical loss rates would reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool. Do you agree with that approach?

Response: The Committee believes that impairment should be based on expected loss rates consistent with the way market participants value assets based on expected cash flows. The use of expected loss rates should be benchmarked to actual activity to ensure that management has a robust estimation process.

Question 69: Do you agree with the proposed delayed effective date for certain aspects of the proposed guidance for nonpublic entities with less than \$1 billion in total consolidated assets? If not, why?

Response: The Committee believes that a four-year delay is reasonable and would provide smaller nonpublic entities time to prepare for the new guidance.

The Committee appreciates the opportunity to respond to this Proposed Accounting Standards Update. Please direct any questions or concerns to VSCPA Government Affairs Director Emily Walker at ewalker@vscpa.com or (804) 612-9428.

Sincerely,

Jamie C. Wohlert, CPA Chair, VSCPA Accounting and Auditing Advisory Committee

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