April 10, 2006

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
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File Reference No. 1250-001

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide our perspective on the Exposure Draft of a Proposed Statement, The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115. The organization and operating procedures of the Committee are reflected in the attached Appendix A to this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which the members are associated.

Our letter first addresses issues not explicitly asked about in the ED, but which the Committee believes need to be addressed. The letter then provides our views on the seven issues listed in the ED.

Contract-by-Contract Nature of Proposal
The Committee believes the contract-by-contract nature of a firm’s choice with respect to the proposed fair value option will inevitably lead to abuse and earnings manipulation. Although the Board asserts the fair value option will allow firms to eliminate mismatches that currently arise when offsetting assets and liabilities have different valuation bases, the proposed standard is at least as likely to allow firms to create such mismatches if they believe it would result in a reporting benefit. Similarly, the Board states that a goal of the proposal is to eliminate reported earnings volatility when that may not be representative of the underlying economics. However, it will also enable firms to avoid volatility in reported earnings when that is representative of the underlying economics. Based on this aspect of the proposal alone, we urge the Board to reject it.

We also believe the contract-by-contract nature of the fair value option makes the “irrevocable option” not really irrevocable. Because the fair value choice is made at the inception of each asset or liability, converting to (or from) fair value accounting requires
only the sale of an asset or the liquidation of a liability, and the replacement of it with a similar one. There would be a second "irrevocable option" with the new asset or liability, at which time the valuation base could be changed from the original. This would effectively enable firms to switch back and forth between valuation bases for individual contracts at any time. Again, the opportunity for abuse is clear.

The Committee would be more inclined to support a fair value option under one of the following conditions:

- An option to put either all financial assets and all financial liabilities at fair value or none of them at fair value.
- A categorization of financial assets and financial liabilities and an option to put all or none of the assets and liabilities in each category on fair value.

Either of these approaches would reduce the opportunity for abuse we believe is inevitable with a contract-by-contact option.

The Committee believes that if the Board pursues the fair value option further, it should consider determining which assets and liabilities are to be stated at fair value on an industry-by-industry basis through industry standards, rather than by individual firms. Doing so would lead to greater consistency across firms and also reduce the potential for abuse.

Finally, we would also be more supportive of the concept of a fair value option if the Board experimented with it first, by allowing companies to provide supplemental financial statements using it.

**Simplifying Hedge Accounting**

The Committee endorses the principles underlying hedge accounting and feels that current hedge accounting rules would benefit from simplification. We encourage the Board to simplify these rules. However, the Committee does not believe the appropriate way to achieve hedge accounting simplification is by creating a loophole intended to get hedge accounting results without following hedge accounting rules.

**Fair Value Accounting and Dual GAAP**

The Committee believes that if the Board moves more toward fair value accounting, then it needs to consider having a separate set of standards for smaller entities. Those entities will not have the resources to comply with fair value standards. Furthermore, the benefits of fair value accounting would be more questionable for these firms.

**Comments on Specific Issues**

The following comments relate to the specific issues set forth by the Board. Although we oppose the proposed standard in principle, we have still provided comments on these issues, which presume the proposal is adopted. The fact that we have commented on these issues should not be interpreted as supporting the proposal.
Issue 1:
With respect to the assets and liabilities listed by the Board in its question, the Committee is concerned about the ability of firms to determine fair values. Most of these assets and liabilities do not have liquid markets, which will bring an added component of subjectivity to valuing these items. We are also skeptical about auditors' abilities to attest to these fair value assertions with any confidence. The combination could enable managements that wish to manipulate earnings and leave auditors with little ammunition to challenge objectively the assigned values.

It is not clear that fair value is appropriate in all cases even when liquid markets exist. There is no guarantee a firm could liquidate its holdings at that value, for example if its holdings were substantial enough. In those same cases (where the firm's holdings are substantial), the firm might be in a position to create gains (or losses) by putting buying or selling pressure on a security through its trading activity. Thus we have concerns about the scope of this proposal that go well beyond the items asked about under the heading of Issue 1.

Issue 2:
Our concerns about the ability of firms and auditors to measure the values of firm commitments are similar to the concerns we described under Issue 1 with respect to other assets and liabilities. In addition, as we discussed under "Simplifying Hedge Accounting," the need for this provision would be eliminated if people felt hedge accounting rules were operating effectively.

Issue 3:
The Committee does not believe that valuing demand deposits is significantly more difficult than valuing equity method investments. This is not a suggestion that demand deposits be accounted for using fair value, but rather a comment on the inconsistencies in what is included in and excluded from the scope of the ED.

Issue 4:
The Committee agrees with the exclusion of these items from the scope of the standard. The Committee believes that the proposed statement should specifically exclude financial assets recognized under sales-type leases and direct financing leases, which Appendix A indicates is the intent. The Committee does not believe it is clear that assets recognized by lessors under sales-type leases or direct financing leases would not be included in the scope of the proposed statement as paragraph A6(c) asserts. The Committee believes that if lease obligations are a financial liability, then lease receivables are arguably a financial asset and therefore need to have an explicit exclusion.

The Committee encourages the Board to reconsider the entirety of lease accounting. At that time, the Board should consider the extent to which lease obligations and lease receivables should be accounted for at fair value.
Issue 5:
Phase 2 of the project will include assets and liabilities whose fair value estimates are even more unreliable than the ones that concerned us in this phase. Therefore, the Committee believes the concerns we have about the fair value option will become even more severe. As such, we do not foresee phase 2 resulting in improved financial reporting. The Committee believes it will exacerbate, not mitigate, reporting problems. If a fair value option is permitted for those assets and liabilities, particularly under a similar asset-by-asset and liability-by-liability approach, we believe it will lead to additional reporting abuses. Finally, it would not simplify accounting because of the difficulty of determining and auditing fair value estimates, not to mention the cost of those activities.

Issue 6:
Recording a gain as the value of liabilities fall due to declining creditworthiness makes sense only if the assets, which presumably are falling in value, are marked to market as well. Then the gains on the liabilities will partially offset the losses on the assets, with the net effect being the loss in value of the equity. However, because the proposed standard does not require assets to be accounted for using fair value, this would not necessarily be the case. And, current impairment rules (e.g., for fixed assets) are not sufficient to ensure assets would be written down to fair value. Thus firms could be recording net gains as their creditworthiness deteriorates. In an ironic twist, these gains potentially delay debt covenant violations, depending on how those covenants are written.

Issue 7:
The Committee believes that gains and losses from fair value adjustments must be segregated from other elements of income, and that this would be best achieved through other comprehensive income. That is, all valuation adjustments to assets and liabilities accounted for at fair value under this standard would be reflected in other comprehensive income until the related asset or liability was liquidated. At that point, the cumulative other comprehensive gain or loss would be removed and a gain or loss would be recognized. If other comprehensive income is not used, then a separate section of the income statement would be necessary to segregate these items.

Sincerely,

[Signature]

James L. Fuehrmeyer, Jr., Chair
Accounting Principles Committee
APPENDIX A

ILLINOIS CPA SOCIETY
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2005-2006

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education, government and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.

Current members of the Committee and their business affiliations are as follows:

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Large (National Firms):
- Matthew L. Brenner, CPA
- James L. Fuehrman, Jr., CPA
- Brian L. Hecker, CPA
- John A. Hepp, CPA
- Alvin W. Herbert, Jr., CPA
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- Plante & Moran, PLLC
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- University of Illinois at Chicago
- Loyola University

- Illinois CPA Society