April 12, 2006

Mr. Lawrence Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116


Dear Mr. Smith:

The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) appreciates the opportunity to comment on the Exposure Draft (ED) of the proposed Statement of Financial Accounting Standards, The Fair Value Option for Financial Assets and Financial Liabilities (FVO Statement). AcSEC shares the Board's view of the merits of expanding the use of fair value measurements for all financial assets and liabilities. We believe the FVO Statement is a step in the right direction towards achieving that goal. The FVO Statement will help to overcome the unfortunate consequences of the mixed attribute accounting model and restore accounting symmetry where the fair value option is elected. We are, therefore, generally very supportive of the FVO Statement, which, in the short run, reduces operational risk by enabling entities to apply simpler economic hedging techniques to offset the changes in the fair values of related assets and liabilities instead of complying with the complex hedge accounting provisions of SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133). In addition, we support the decision to allow entities to elect fair value accounting on a contract-by-contract basis, rather than by broader categories, thereby allowing more flexibility and making this election more practical for financial statement preparers. We agree that this election should be irrevocable.

AcSEC also supports the Board's efforts to achieve greater convergence with the IASB, despite the fact that the proposed Statement will not achieve perfect convergence. We view the FASB's version as generally superior to that of the IASB, whose IAS 39, Financial Instruments: Recognition and Measurement, is more restrictive in permitting a fair value option for financial instruments.

Although we firmly believe that the Board should finalize and issue the FVO Statement under Phase 1 of the Fair Value Option project as soon as possible, we recognize the new challenges it introduces for measuring fair value for a number of financial instruments with nonfinancial components. Since the implementation of the FVO Statement would be affected by the proposed Statement of Financial Accounting Standards, Fair Value Measurements (FVM), and proposed FSP FAS 133-a, Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value under Statement 133 (FSP 133-a), we strongly recommend that the mandatory effective date of the FVO Statement should not precede that of the FVM Statement and FSP 133-a, and desirably should be later.
Some entities may wish to adopt the FVO Statement early, prior to issuance of the FVM Statement. Such early adoption should be permitted. We believe that other entities will want to wait and understand the requirements of the final FVM Statement before deciding whether to apply the FVO Statement. Some of those entities will face significant challenges adopting both the FVO and FVM Statements simultaneously, because of the inadequacy of the systems in place to measure and provide required disclosures related to fair values. As a result, an entity that does not adopt at the effective date (because systems are not yet in place) will lose the one-time chance to elect FVO for existing financial assets and liabilities. We therefore recommend that the FVO Statement have a later required effective date than the FVM Statement. This concern would be mitigated to the extent that the FVM Statement has an extended period between issuance date and effective date.

The determination of which insurance and reinsurance contracts are financial instruments has not been resolved in current guidance, as SFAS No. 107, Disclosures about Fair Value of Financial Instruments, excludes insurance contracts, other than financial guarantees and investment contracts, from its scope. It is therefore unclear what current reference the FASB intends to be used for determination of whether an insurance or reinsurance contract is a financial instrument.

While the FVO Statement allows entities to elect fair value accounting on a contract-by-contract basis, rather than by broader categories, the level of aggregation that is normally applied to insurance and reinsurance contracts is at a portfolio level. Since insurance contracts are valued using actuarial methodologies that depend on the "law of large numbers" in estimating claim amounts, there is a question of whether a specific insurance contract’s value (rather than a portfolio’s value) is credible. Additionally, entities which elect the FVO for other small homogeneous items, such as consumer loans, face similar measurement issues when attempting to determine whether dividing the portfolio value pro rata among the contracts comprising the portfolio would always result in an appropriate fair value for a single contract. While these questions remain unresolved, AcSEC thinks that the FVO Statement should not preclude election of the FVO at the portfolio level, but the measurement unit-of-account issue should be addressed as part of the FVM Statement.

We have provided more specific comments in the enclosed attachment.

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We thank the Board for its consideration and would welcome the opportunity to further discuss this matter with Board members and their staff.

Sincerely,

Ben Neuhausen
Chairman
AcSEC

Linda Bergen
Chair
Fair Value Option Task Force
Issue 1: The scope of this proposed Statement includes the following financial assets and financial liabilities that some may not have considered as being included:

a. An investment being accounted for under the equity method
b. Investments in equity securities that do not have readily determinable fair values, as described in paragraph 3 of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities
c. Insurance and reinsurance contracts that are financial instruments, as discussed in FASB Statements No. 60, Accounting and Reporting by Insurance Enterprises, No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, and No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts
d. Warranty obligations that are financial liabilities and warranty rights that are financial assets
e. Unconditional purchase obligations that are recorded as financial liabilities on the purchaser's statement of financial position as discussed in paragraph 10 of FASB Statement No. 47, Disclosure of Long-Term Obligations.

Should an entity not be permitted the option to initially and subsequently measure those financial assets and financial liabilities or any others at fair value? If so, why should those financial assets and financial liabilities be excluded from the scope of this proposed Statement?

a. AcSEC has mixed feelings about including equity method investments in the scope of the FVO, particularly when the equity method investee is an operating entity (for instance, a real estate limited partnership or entity dedicated to R&D type activities). It seems counterintuitive that an entity that sells a real estate property, holds a 25% equity interest in the purchaser, and elects fair value for that equity method investment under the FVO, recognizes the entire gain on the real estate asset immediately, whereas FAS 66 would currently allow only pro rata partial recognition of the gain to the extent of the third-party ownership in the purchasing entity.

However, because of the benefits that the FVO would provide to many entities, AcSEC does not object providing the fair value option for investments accounted for under the equity method. Since these investments cannot currently be hedged under FAS 133, the ability to recognize them at fair value would be useful for investors that would like to economically hedge their equity method investments. It would also be useful for investments made by investment companies that no longer qualify under the expected scope changes to the AICPA Investment Company Audit Guide and for entities that have equity method investments in start-up or venture capital type businesses (where the entity does not fall under the scope of the AICPA Investment Company Audit Guide). Under equity method accounting, entities will typically recognize a loss on these investments at the first reporting date (as the underlying company is not yet profitable), which may not represent the most faithful economic depiction of the investment. Measuring these investments at fair value would address this concern.
AcSEC believes that, if the Board decides to include the equity method investments in the scope of the FVO Statement, the final Statement needs to clarify explicitly that once fair value measurement has been elected, the investment is not an equity method investment and any accounting guidance that applies to equity method investments (e.g., intercompany profit elimination in accordance with APB Opinion No. 18 and SOP 78-9) is no longer applicable. However, AcSEC believes that SFAS No. 57, Related Party Disclosures, still should apply to transactions with equity method investees accounted for on a fair value basis.

b. We agree with including equity securities without readily determinable fair values in the proposed scope. Although bid-asked prices for such securities may not be available from a securities exchange or over-the-counter market, the proposed FVM Statement addresses the issue of how such fair values should be estimated and in which level of the fair value hierarchy they would fall. This highlights the importance of coordinating the issuance of the FVO Statement with the final release of the FVM Statement.

c. AcSEC believes that insurance and reinsurance contracts that are financial instruments should be included in the scope of this proposed Statement and be eligible for the fair value option, but believes that there is significant confusion as to which insurance and reinsurance contracts would be considered financial instruments.

The determination of which insurance and reinsurance contracts are financial instruments has not been resolved in current guidance, as paragraph 8(c) of SFAS No. 107, Disclosures about Fair Value of Financial Instruments, excluded insurance contracts, other than financial guarantees and investment contracts, from its scope. FASB Financial Accounting Series, “Preliminary Views, Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value,” issued in 1999 discussed financial instrument determination for insurance and reinsurance contracts. The Preliminary Views document stated that “many insurance policies are financial instruments. If specified conditions are satisfied, the policy issuer is obligated to deliver cash, and the policyholder has the right to require the policy issuer to deliver cash. That is a conditional obligation to deliver cash and a corresponding conditional right to require delivery of cash, which is a financial instrument. However, if an insurance policy requires the policy issuer to provide goods or services (for example, replacement products, healthcare services, or prescriptions), the policy is not a financial instrument.” It also continues to state that “it may not always be clear whether or not a particular policy requires delivery of cash.” It is unclear what current reference the FASB intends to be used for determination of whether an insurance or reinsurance contract is a financial instrument. AcSEC recommends that the final guidance clearly state the criteria to be used in determining which insurance and reinsurance contracts should be designated as financial instruments to avoid significant inconsistency in application of this Statement. Examples of the application of the criteria would be helpful.

d. We do not object to including warranty obligations in Phase 1 of the project instead of Phase 2, although it seems inconsistent because the obligations and rights related to warranties are frequently a functional part of a nonfinancial asset rather than a financial asset.

e. Like warranty obligations above, we do not object to including unconditional purchase obligations that are recorded as financial liabilities on the purchaser’s statement of financial position in Phase 1 of the FVO, although they also seem to belong more appropriately to Phase 2 of the project.
Issue 2: This proposed Statement permits an entity to elect the fair value option at inception for a firm commitment that would otherwise not be recognized at inception under existing generally accepted accounting principles (GAAP) and involves only financial instruments. Should an entity be permitted the option to recognize those firm commitments at fair value at inception of the contract? If so, why is the availability of the fair value option election important for those contracts and what types of entities would likely avail themselves of that fair value option election? Should the scope be limited to forward contracts that meet the definition of firm commitments under FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (that is, requiring that the terms of the forward contract include a disincentive for nonperformance that is sufficiently large to make performance probable)? If not, why not?

We support letting entities elect fair value for firm commitments that would otherwise not be recognized under existing GAAP. The main benefit of such an election is that it restores accounting symmetry and allows entities to hedge such commitments economically, including those that did not qualify for hedge accounting under FAS 133, without increasing volatility in earnings.

However, the Board should clarify which firm commitments qualify for the fair value option. Written loan commitments (other than mortgage loan commitments held for sale) would frequently not meet the definition, since they may lack disincentives for nonperformance. As a result, some constituents have difficulty distinguishing between the commitments that are excluded and those that would be included in the scope of FAS 133. Moreover, since firm commitments that would involve commodities would fit in Phase 2 only, and written loan commitments are excluded in Issue 3 below, it seems unclear which firm commitments, if any, would be included in Phase 1.

Issue 3: The scope of this proposed Statement would exclude both (a) written loan commitments that are not accounted for as derivative instruments under Statement 133 and (b) financial liabilities for demand deposit accounts. The Board decided to specifically exclude those financial instruments, since the determination of their fair values involves consideration of nonfinancial components. Should an entity be permitted the fair value option election for those financial instruments? If so, why? What would be the appropriate unit of account for determining the fair value of demand deposit liabilities? What other financial assets and financial liabilities for which their fair values involve consideration of nonfinancial components should be excluded from the scope of this proposed Statement?

The exclusion of written loan commitments and demand deposit accounts from the scope of Phase I because the fair value of these financial instruments involves the consideration of nonfinancial components seems to be inconsistent with the treatment of other financial instruments under the scope of the FVO. Nonfinancial components are considered in the determination of fair value for many financial instruments including insurance contracts (e.g., mortality rates), mortgage loans (e.g., prepayment drivers), and warranty obligations (as previously described). In our view, the consideration of these factors does not warrant exclusion from the scope of the FVO. We believe that any specific concerns the Board has with respect to the valuation of written loan commitments and demand deposit accounts can be addressed as described below without the wholesale exclusion of these financial instruments from the scope of Phase I.

(a) We think that written loan commitments should be included in the scope of Phase 1. Credit exposures of loans and loan commitments are generally managed together as one portfolio. Although the servicing asset may not be recognized until contractually separated from the funded loan, it is possible to determine a fair value for the entire loan commitment as is already done for derivative commitments. Loan commitments are valued using the same techniques
as are used for funded loans, which also have a servicing component but are included in the FVO scope, so having only the funded loans eligible for the FVO is inconsistent. Furthermore, loan commitments are frequently sold prior to funding, so there is often an observable market price.

(b) We think that financial liabilities for demand deposits should similarly be included in Phase 1 of the project. We believe the measurement issues for deposit liabilities can be overcome and suggest that the FASB follow the IASB’s lead by requiring in Phase 1 that the fair value of deposits cannot be less than the face amounts, and consider the valuation issues more thoroughly in Phase 2.

Furthermore, AcSEC believes it is unclear as to what contracts are considered to be demand deposit accounts. Paragraph A6(e) implies that financial instruments with nonfinancial components are excluded. AcSEC is uncertain as to whether some insurance contracts (for example, universal life-type contracts and most, if not all, investment contracts such as deferred annuities with insignificant mortality risk) that include surrender provisions would be classified as demand deposit accounts or whether FASB intends this exclusion to apply only to bank demand deposits. Therefore, if the Board decides to maintain its proposed scope exclusion of demand deposit accounts for Phase 1, AcSEC recommends that the FASB provide a clear definition of demand deposit accounts, to allow consistency in the determination of which contracts would meet that exclusion, along with examples of contracts that would be excluded from electing the fair value option.

Issue 4: The scope of this proposed Statement would also exclude:
   a. An investment that would otherwise be consolidated
   b. Employers’ and plans’ financial obligations for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements as defined in FASB Statements No. 35, Accounting and Reporting by Defined Benefit Pension Plans, No. 87, Employers’ Accounting for Pensions, No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions, No. 112, Employers’ Accounting for Postemployment Benefits, No. 123 (revised December 2004), Share-Based Payment, No. 43, Accounting for Compensated Absences, and No. 146, Accounting for Costs Associated with Exit or Disposal Activities, and APB Opinion No. 12, Omnibus Opinion—1967
   c. Financial liabilities recognized under lease contracts as defined in FASB Statement No. 13, Accounting for Leases. (This exclusion does not include a contingent obligation arising out of a cancelled lease or a guarantee of a third-party lease obligation.)

The Board decided to specifically exclude those financial assets and financial liabilities from the scope of this proposed Statement, as the Board believes that any modifications to the accounting for such financial assets and financial liabilities should be part of a reconsideration of those areas and should not be affected by the fair value option. Should an entity be permitted the fair value option election for those financial instruments? If so, why?

a. We agree that investments otherwise to be consolidated should be excluded, because consolidation should not be avoided by making a fair value election. Consolidation properly presents the combined financial position and results of operations of entities that are controlled or where a majority of the risks and rewards are held by the parent.
b. We agree that the scope should exclude these benefit obligations. The Board has spent considerable time and effort establishing the appropriate accounting for share-based compensation and has major projects on pension and postretirement plan accounting underway. These are the proper forums for establishing the propriety of fair value accounting for such benefits.

c. We agree that the scope of the FVO should not include financial liabilities recognized under lease contracts. We do, however, recommend that the Board specifically clarify, within the body of the final standard, that lessor receivables accounted for under SFAS No. 13, Accounting for Leases, are also excluded from the scope of the FVO. SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, states that minimum lease payments, because of a lessor’s right to collect cash from the lessee, meet the definition of a financial asset. Therefore, the statement in the Basis for Conclusions that assets recognized by lessors under sales-type leases, direct financing leases, or leveraged leases could not be considered purely financial assets is inconsistent with Statement 140. We believe a specific scope exception in the body of the standard is required. In addition, we recommend that the FASB clarify whether the investment made by the lessor in an entity (e.g., corporation, trust, LLC, or LLP) whose sole asset is a leveraged lease would be considered an equity security (i.e., a financial instrument eligible for the FVO) within the scope of the proposal or as an investment in a leveraged lease which would be scoped out of the FVO.

If lease accounting is to be reconsidered, we believe that the Board needs to do so as part of a separate project. Until then, the election of a FVO would only exacerbate the complexity of existing lease accounting.

Issue 5: As noted above, this proposed Statement represents Phase 1 of the fair value option project. Phase 2 will consider permitting the fair value option for selected nonfinancial assets and liabilities. The Board is seeking input on what nonfinancial instruments should be included in the scope of Phase 2. Please provide details of those nonfinancial instruments and why they should be eligible for the fair value option. How would applying the fair value option to those nonfinancial instruments (a) improve financial reporting, (b) mitigate problems for reported earnings caused by the mixed-attribute model, and (c) enable an entity to simplify its accounting methods? Is fair value information readily available for those nonfinancial instruments?

While AcSEC was divided on this issue, the overall sentiment was to ask the Board to include forward commitments that cannot be settled in cash but only in physical commodities in Phase 2 of the project. Since fair value is the most relevant measurement attribute, these forward commitments should be eligible for the FVO because of their economic similarity to those settled in cash, which are included in Phase 1 of the FVO. Commodity dealers do not distinguish between cash-settled and physically-settled forward commitments in determining the contracts’ fair values. Accordingly, AcSEC believes commodity traders should be able to elect fair value accounting for all of their forward commitments, as well as their physical inventory positions that are often hedged by these forward commitments. Additionally, AcSEC also believes that the Board should expand the proposed FSP 133-a to provide additional guidance on day-1 gain/loss recognition for commodity-settled forwards and other instruments that are not considered derivative instruments under SFAS 133.
Changes in Creditworthiness

Issue 6: This proposed Statement would permit an entity to elect the fair value option for certain financial liabilities, including debt liabilities. Under this proposed Statement, an issuer who has elected the fair value option for its debt liabilities would report changes in fair value of those liabilities, including changes resulting from changes in that issuer's own creditworthiness, as gains and losses in earnings. If significant changes in fair value of those liabilities occur during a period, qualitative disclosures about the nature of those changes would be required. The Board discussed several possible approaches for curtailing the debtor's recognition of the portion of a liability's changes in fair value that is attributable to changes in its own creditworthiness and determined not to provide any curtailment; instead, the Board decided that liabilities should be recorded at fair value when the fair value option has been elected with all changes in fair value recorded in earnings. Do you agree with the Board's decision? If not, why not? What alternative approaches or additional disclosure requirements should the Board consider?

While we agree that, conceptually, creditworthiness should be considered in determining the fair value of liabilities, including an entity's own debt, we have significant concerns about how such application would affect how entities show their true indebtedness on the statement of financial position. For instance, when an entity's credit rating falls, it seems counterintuitive that a gain should be recognized when the entity is still contractually liable for the original amount borrowed. Although one could argue that the liabilities should decrease in step with the lower credit rating as an entity moves closer towards bankruptcy, in reality such a near-bankrupt entity would not be able to realize the gains associated with the smaller fair value of its debt, because it would lack the necessary cash to retire the debt. The option to report liabilities at fair value would have an impact on SOP 90-7, Financial Reporting by Entities in Reorganization under the Bankruptcy Code, and adds to an uncertainty regarding how companies who are either approaching or have already entered into a bankruptcy reorganization should fair value their own debt. Despite these concerns, AcSEC agrees that a debtor's recognition of changes in the fair value of its liabilities for which the FVO option has been elected should not be curtailed in any way. We also agree that the statement of financial position should show contract value parenthetically, since we believe that contract value is of paramount importance to creditors in evaluating an issuer's long-term debt and its creditworthiness.

Because the debtor and creditor may make different elections under the FVO Statement, there will inevitably be inconsistency in reporting between debtors and creditors. We believe the advantages of the FVO outweigh the disadvantages of such inconsistencies.

One of the main anticipated benefits of the FVO Statement is enabling entities to use simpler economic hedging and avoid some of the complexities of fair value hedge accounting under FAS 133. Because of the requirement to consider creditworthiness as part of the fair value measurement by the issuer, this benefit may not always be realized. Entities hedging their liabilities after fair value accounting has been elected could have some volatility in earnings related to their own credit spread that would not occur under FAS 133, where the issuer's creditworthiness is not included in a debt instrument's fair value. Accordingly, some entities may continue to utilize the hedge accounting provisions of FAS 133.
Presentation and Disclosure Requirements

Issue 7: The Board discussed several possible approaches for separately reporting changes in the fair values of financial assets and financial liabilities measured at fair value pursuant to the election of the fair value option in the income statement or in the notes to the financial statements. The Board decided that an entity should provide information that would allow users to understand the effect of changes in the fair values of assets and liabilities subsequently measured at fair value as a result of a fair value election, but it did not prescribe detailed guidance on where and how that information should be reported. How should changes in the fair values of assets and liabilities subsequently measured at fair value as a result of a fair value election be reported? Should those changes be aggregated with the effect on earnings derived from other similar financial assets and financial liabilities in the income statement, or should separate display of those changes in the income statement be required? What level of aggregation should be permitted? What additional disclosure requirements should the Board consider?

Constituents are unclear and struggling with what their financial statements should look like in this new fair value world. Currently, this issue is dealt with only for trading securities and derivative positions. Although we understand that the Board’s intention is not to be prescriptive about the financial statement presentation and disclosures of the effect of marking to market, we think the Board needs to provide additional guidance sooner than the Board’s project, Reporting Financial Performance, is finalized. Therefore, we ask the Board to provide a sample income statement in the FVO Statement, because we think it would be helpful and would increase reporting consistency among constituents.

Paragraph 12 of the FVO Statement is not clear about whether realized and unrealized gains or losses should be reported separately in the income statement. The proposed FVM Statement requires entities to disclose any unrealized gains and losses during the reporting period that resulted from the remeasurements of assets and liabilities that the entity still holds at the reporting date. However, existing reporting systems for securities may not track realized versus unrealized gains and losses, and reporting systems for other assets and liabilities that could now be reported at fair value do not currently exist. Therefore, some entities may require additional time to get systems in place to implement the FVO Statement.

The proposed FVO Statement permits the election of the fair value option to be made on a contract-by-contract basis. The FVM working draft states that “fair value is the price that would be received for an asset or paid to transfer a liability in a current transaction between marketplace participants in the reference market for the asset or liability.” It also discusses that the reference market is the most advantageous market in which the entity would transact for the asset or liability, and that reference markets will differ in part due to the unit of account for the asset or liability in the most advantageous market in which the entity would transact for the asset or liability (level of aggregation). For insurance and reinsurance contracts, this level of aggregation would normally be at the portfolio rather than contract-by-contract basis. AcSEC requests that the FASB reconcile the concepts between the proposed FVO Statement and the FVM project, and clarify in the final Statement whether it is appropriate to do an aggregate valuation for a category of insurance/reinsurance contracts that are aggregated, where the fair value option has been selected for a portfolio rather than on a contract-by-contract basis.

Additionally, while the FVO Statement allows entities to elect fair value accounting on a contract-by-contract basis rather than by broader categories, the level of aggregation that is normally applied to insurance and reinsurance...
contracts is at a portfolio level. If the FVO Statement in fact allows insurance contracts to be valued at fair value on a contract-by-contract rather than portfolio basis, the question remains whether an insurance contract value is credible given that actuarial methodologies depend on the “law of large numbers” in estimating claim amounts. The Board should therefore clarify whether the appropriate basis for electing fair value for insurance contracts is at an individual contract or an insurance contract portfolio level.

Other Issues

Definition of a Contract
As the Exposure Draft allows the election of FVO on a contract-by-contract basis, defining what a contract represents would be helpful when considering whether this concept could be applied to individual units (e.g., bonds or shares) as well as investments that are not unitized, such as limited partnership interests. Consider the following examples that raise issues where we believe additional clarity on the definition of a contract would be helpful:

- Entity has an existing investment accounted for as available-for-sale under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and decides not to elect the FVO for this investment upon adoption of the FVO Statement. Subsequently, the entity purchases additional shares that move the accounting for the investment to the equity method. Would the entity be able to elect the FVO for the additional investment, the entire investment (which is now an equity method investment), or not at all?

- Entity has an existing equity method investment and decides not to elect the FVO at adoption of the FVO Statement. Subsequently the entity increases its investment (but not to a level requiring consolidation). Would the entity be able to elect the FVO for the additional purchase, with the original investment still accounted for under the equity method? Or conversely, if entity had elected the FVO for the initial investment, would entity be required to account for the additional investment under the FVO?

- Entity has an investment that must be consolidated at the time the FVO is adopted, so the investment is scoped out of the FVO Statement. Subsequent to adoption of the FVO Statement, the entity sells a portion of its holding so the investment is now accounted for using the equity method of accounting. In this case, guidance in the FVO Statement would seem to say that entity cannot elect the FVO at the time of sale because no “remeasurement event” has occurred.

Loan Origination Costs
AcSEC would like to bring to FASB’s attention another question we think may need to be revisited relating to SFAS No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91). Since the FVO applies to originated as well as purchased loans, when the FVO for such loans has been elected, the question becomes whether the FAS 91 principle of amortizing origination fees and direct loan origination costs over the life of the loan needs to be reconsidered. In our opinion, a loan originator that has elected to mark the loan to market and, therefore, recognize any unrealized gains or losses associated with such loans immediately, should no longer be allowed to defer the costs related to funding the loan. Although paragraph 3 in FAS 91 states that the Statement does not apply to costs of originating or acquiring loans that are marked to market with changes recorded in earnings, the Board should clarify that this guidance should be applied to loans where the FVO is elected and the lender should instead expense any costs related to origination immediately. If the FVO is elected for existing loans at the date of adoption of the FVO Statement, then any previously deferred costs for those loans should be written off as part of the cumulative effect of the accounting change.

Deferred Acquisition Costs and Unearned Premiums
AcSEC recommends that the FASB also explain how fair value accounting for an insurance or reinsurance-related financial liability would impact the other aspects of accounting for the contract, for example, the accounting for the unearned premium and deferred acquisition costs. Unlike FAS 91, which is clear that deferral of costs is not allowed for loans carried at fair value, the insurance standards are not clear about whether acquisition costs should continue to be deferred if the fair value option is elected. AcSEC is also unclear whether all contract activity should be reported as a single line change in fair value or if other contract components (e.g., premiums, change in benefits) should continue to be reported applying previously applicable insurance accounting (SFAS Nos. 60, 97 and 113).

Net Presentation of Economic Hedges
When entities are allowed to elect the FVO for financial assets and liabilities, their motivation for doing so is often the ability to apply economic hedges to such mark-to-market positions. We believe that if entities have in fact applied such economic hedges, the Board should allow net presentation of economic hedges in the income statement as it would better reflect economic substance in the financial statements.

Transfers of Investments to Trading
We view the Board’s allowing a one-time “transfer holiday” that would permit the reassignment of securities classified as either held-to-maturity or available-for-sale under SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities (FAS 115), to the trading category at the time the final standard is adopted as a positive step that facilitates the objective of achieving full fair value for all financial instruments. However, we would like to point out that the term “trading,” which designates a category subject to FAS 115, would be misleading after the FVO takes effect, since the company may intend a longer-term holding period than “hours or days.” Although companies are currently permitted to classify securities as “trading” even if their intended holding period is not as short as “hours or days,” once the fair value option is effective, we believe there will be more securities included in the trading category for which the intended holding period is significantly longer. Accordingly, we think the Board should consider renaming this category so it is clear that not all such securities are held for trading purposes.

Definition of Financial Asset and Financial Liability
We recommend that the definitions of a financial asset and a financial liability in the Exposure Draft clarify whether the contractual rights and contractual obligations associated with these assets and liabilities encompass rights and obligations that are both conditioned on the occurrence of a specified event as well as those that are not. In addition, as currently written, it is unclear to us whether a financial asset and a financial liability, as defined in the Exposure Draft, would encompass contractual rights or obligations to receive or deliver a chain of contractual rights or obligations that ends with the delivery of cash or an ownership interest in an entity, as this concept is described in the definition of a financial instrument under Statements 107 and 150.

Implications for Not-for-Profit Organizations
The implications of the FVO Statement for Not-for-Profit Organizations (NPOs) are unclear. Appendix A of Chapter 8 of the AICPA Audit and Accounting Guide, Not-for-Profit Organizations, generally requires NPOs to report investments either all at fair value or all at cost. Would the FVO Statement eliminate this “all or nothing” provision for investments in financial assets? It is not clear whether the FVO Statement would allow a NPO currently reporting all its investments in financial assets at fair value or at cost to change its accounting so that it elects fair value for certain, but not all, of its investments in financial assets. Furthermore, if a NPO currently reports all its investments in financial assets at fair value, but would like to use the fair value option selectively, would a move to cost method for
the remaining investments upon the adoption of the FVO be acceptable, given the FASB’s stated preference for fair value accounting?

The FVO Statement would provide that the election of the FV option requires that changes in FV be recognized “in earnings (or other performance indicators for entities that do not report earnings).” Pursuant to SFAS No. 117, *Financial Statements of Not-for-Profit Organizations*, NPOs are required to report changes in net assets and do not report earnings. NPOs are permitted, however, to report an intermediate measure of operations, if it is clearly defined, though most NPOs do not report an intermediate measure of operations. In addition, NPOs that report an intermediate measure of operations may define that measure in a manner that differs from earnings of a business enterprise. (For example, in order to illustrate a dependence on contributions to support program activities, an NPO may exclude all contributions from its measure of operations so that it is apparent that the reduced fees that the NPO charges its service constituents do not cover the cost of providing those services.) Is the term “performance indicator” intended to encompass all self-defined measures of operations? If so, this provision would require that a measure of operations include changes in FV resulting from the FV election, while other changes in FV, in accordance with FAS 117, could be placed inside or outside of that measure. For NPOs that do not report an intermediate measure of operations, would the requirement be to simply report changes in FV of financial assets as part of changes in net assets? Also, should this provision trigger a revision to FAS 117 to somewhat limit the flexibility in defining an NPO measure of operations, in that a measure of operations, if reported, would have to include changes in FV resulting from the FV election (but not necessarily other changes in FV)?