



April 30, 2015

Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2015-220

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update—*Disclosures about Hybrid Financial Instruments with Bifurcated Embedded Derivatives*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

Although we are supportive of the Board's efforts to increase the transparency and usefulness of the information provided in the notes to the financial statements about hybrid financial instruments that contain embedded derivatives, we do not support finalization of the proposed guidance.

First, we are not aware of user demand for the information the proposed disclosure requirements would provide. In our view, linking the components of a hybrid financial instrument in the manner suggested in the proposed ASU provides minimal incremental information to users because the proposed disclosures fail to allow the user to reassemble the hybrid financial instrument. This is because the components retain disparate measurement bases and the disclosure requirements exclude equity classified components such as beneficial conversion features and cash conversion options. Therefore, we believe the cost of providing the proposed disclosure outweighs the potential benefit to users.

Second, we believe that the proposed guidance adds another layer of disclosure requirements to an area of U.S. GAAP that is already a patchwork of disclosure requirements accumulated over many years and various accounting standards. We note that the Board has undertaken a broader effort to address the disclosure framework, and we are supportive of this effort to ensure that the most relevant information is provided to users while minimizing costs to preparers. Given the magnitude of such a project we recognize that incremental disclosure requirements will be necessary before it is completed. However, in our view, the proposed disclosure requirements are not critical and do not warrant expedited implementation before a more comprehensive review of the disclosure framework is completed.

Finally, we believe there are issues with the recognition guidance for embedded derivatives that should be addressed before increasing the prominence of embedded derivatives in the notes to the financial statements. For example, we are aware that the EITF's agenda includes a project to examine the guidance on determining whether an embedded contingent put or call option is clearly and closely related to a debt host contract, and we believe this issue should be resolved before proceeding with a project to enhance the disclosure requirements for embedded derivatives.

Our responses to the proposal's Questions for Respondents follow.

1. *Will the amendments in this proposed Update result in more transparent, decision-useful information about hybrid financial instruments with bifurcated embedded derivatives? If not, please explain why.*

We believe the proposed amendments provide incremental transparency by linking embedded derivatives to their host contracts, but we do not believe the proposed amendments provide sufficient additional decision-useful information to justify their implementation cost.

In our view, the lack of transparency in reporting hybrid financial instruments is primarily due to (1) diversity in practice of applying the recognition guidance for embedded derivatives (e.g. determining whether an embedded put or call option is clearly and closely related to a debt host contract) and (2) the existence of different measurement bases for components of a single hybrid financial instrument.

While the proposed disclosure requirements link embedded derivatives to their host contracts, they do not reconcile the fair value of the hybrid financial instrument to the carrying amounts of its components. We do not suggest that such a reconciliation be required, but rather believe that potential transparency through disclosure is necessarily limited by the Board's decision to continue with the embedded derivative model for accounting for hybrid financial instruments.

Therefore, we believe the best way for the Board to increase the transparency and usefulness of the information provided in the notes to the financial statements about hybrid financial instruments that contain embedded derivatives in the near term is to reduce diversity in practice among issuers applying the recognition guidance for embedded derivatives.

- 2. Should the scope of the amendments in this proposed Update be extended to include nonfinancial hybrid instruments with embedded derivatives that require bifurcation under Topic 815? If yes, please explain why and identify any other instruments that should be included in the proposed amendments.*

We do not believe the scope of the proposed guidance should be expanded to include nonfinancial hybrid instruments with embedded derivatives that require bifurcation. We believe that in many cases, the nonfinancial host contract will not be recognized because it is an executory contract (e.g. an operating lease), and the proposed disclosure requirements would not be operable for such hybrid instruments. We are not aware of a prevalence of recognized nonfinancial hybrid instruments with bifurcated embedded derivatives that warrants expanding the proposal's scope.

If the Board does proceed with the proposed amendments, we believe it should consider including other separated components of hybrid instruments such as beneficial conversion features and cash conversion options within the disclosure requirements. We believe this would provide more comprehensive information to users about the linkage between separately recognized components of a hybrid financial instrument.

- 3. Are the proposed disclosure requirements operable and auditable? If not, which aspects pose operability or auditability issues and why?*

We are concerned that the proposed guidance might not be operable for compound embedded derivatives. According to ASC 815-15-25-7, multiple embedded derivatives that would individually warrant separate accounting as derivative instruments must be accounted for as a single compound derivative. ASC 815-15-25-8 emphasizes that an entity shall not separate a compound embedded derivative into components representing different risks.

The proposed guidance provides an example in which embedded derivatives are aggregated by type, and it is unclear how compound derivatives would be addressed in this sort of tabular disclosure. We acknowledge that this issue likely exists with the existing derivative disclosure requirements, which require quantitative disclosures by type of contract, but we believe the proposed disclosure requirements could cause embedded derivatives not previously deemed material in the context of the overall disclosure

requirements to be material in the context of the proposed disclosures, thereby raising questions about the categorization of compound derivatives by type.

4. *The proposed amendments would apply to all entities. Should the proposed amendments be different for entities that are not public business entities? If so, please describe how and why you think they should be different.*

We do not believe the proposed amendments should be different for entities that are not public business entities. In our experience, many private companies issue complex debt and equity instruments that contain embedded derivatives requiring bifurcation, so if the Board proceeds with the proposed amendments, we believe the proposed guidance should apply to all entities.

5. *How much time would be needed to implement the proposed guidance? Should the amount of time needed to implement the proposed amendments by entities that are not public business entities be different from the amount of time needed by public business entities?*

For public business entities, we do not believe a significant amount of time would be needed to implement the proposed guidance. For other entities, we believe that resource constraints coupled with the complexity of this area of U.S. GAAP warrant a one year deferral relative to the effective date for public business entities.

We appreciate the opportunity to offer our comments.

Sincerely,

Scott G. Lehman, CPA

Chair, Accounting Principles Committee

Ryan Brady, CPA

Vice Chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2015-2016

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education 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 fully study and discuss 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:

Public Accounting Firms:

Large: (national & regional)

Ryan Brady, CPA (Vice Chair)	Grant Thornton LLP
John Hepp, CPA	Grant Thornton LLP
David Jamiolkowski, CPA	Baker Tilly Virchow Krause, LLP
William Keirse, CPA	Ernst & Young LLP
Scott Lehman, CPA (Chair)	Crowe Horwath LLP
Reid Mitchell, CPA	Wipfli LLP
Elizabeth Prossnitz, CPA	BDO USA LLP

Medium: (more than 40 professionals)

Timothy Bellazzini, CPA	Sikich LLP
Christopher Cameron, CPA	Kutchins Robbins & Diamond Ltd
Michael Kidd, CPA	Mowery & Schoenfeld LLC
Matthew Mitzen, CPA	Frost Ruttenberg & Rothlatt PC
Krunal Shah, CPA	Mitchell & Titus LLP
Jeffery Watson, CPA	Miller Cooper & Company Ltd

Small: (less than 40 professionals)

Peggy Brady, CPA	Selden Fox, Ltd.
Marvin Hoffman, CPA	Bronswick, Reicin, Pollack, Ltd.
Brian Kot, CPA	Cray Kaiser Ltd CPAs
Joshua Lance, CPA	Joshua Lance CPA, LLC

Industry:

Rose Cammarata, CPA	CME Group Inc.
Anand Dalal, CPA	Toji Trading Group LLC
Ashlee Earl, CPA	Seaway Bank and Trust Company
Jeffrey Ellis, CPA	FTI Consulting, Inc.
Farah Hollenbeck, CPA	Abbvie
Marianne Lorenz, CPA	AGL Resources Inc.
Michael Maffei, CPA	GATX Corporation
Ying McEwen, CPA	CNH Industrial N.V.
Anthony Peters, CPA	McDonald's Corporation
Martin Ross, CPA	Riveron Consulting LP
Amanda Rzepka, CPA	Jet Support Services, Inc.
Richard Tarapchak, CPA	National Material

Staff Representative:

Gayle Floresca, CPA	Illinois CPA Society
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