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May 19, 2013

Susan M. Cospers, CPA  
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**Re: February 14, 2013 Exposure Draft of a Proposed Accounting Standards Update (ASU), *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities* [File Reference No. 2013-220]**

**and**

**Re: April 12, 2013 Exposure Draft of a Proposed Accounting Standards Update (ASU), *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities—Proposed Amendments to the FASB Accounting Standards Codification* [File Reference No. 2013-221]**

Dear Ms. Cospers:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the EDs and is providing the following comments for your consideration.

#### **GENERAL COMMENTS**

TIC has approached the proposal from the perspective of a nonpublic entity that is not in the financial services industry. TIC has therefore provided responses to only a limited number of the questions for respondents.

TIC believes the new comprehensive recognition and measurement model in this proposal is an improvement over the 2010 ED, which favored fair value as the primary measurement model for financial instruments. The 2013 proposal provides more opportunities for use of the amortized cost method, which TIC prefers.

However, TIC has some concerns about the scope of the ED and believes improvements are necessary to tailor the guidance in the standard to the needs of nonpublic entities. In addition, TIC is requesting exemptions for private companies for certain of the proposed requirements. These points are discussed in detail below.

## Clarity Issues

TIC has significant concerns relating to the clarity of the proposal for nonpublic entities. The ED includes many complex sentence structures or the use of “double negatives” that reduce the reader’s comprehension of the requirements of the document. Illustrative examples of difficult passages include:

- *An entity need not make a detailed assessment if it is clear with little or no analysis that the cash flows of the financial asset under assessment could or **could not be more than insignificantly different** from the cash flows of the benchmark instrument.* (Quoted from 825-10-55-19, last sentence. The highlighted phrase is also used in paragraph 825-10-55-20, last sentence). The language used in this sentence obscures its intended meaning.
- *For example, sales that result from the following events or circumstances **would not be inconsistent** with the objective of amortized cost classification (because the events would occur very infrequently).* [Numerous instances of the highlighted phrase are used in paragraph 825-10-55-32.] Use of straight-forward language promotes clarity. If events would not be inconsistent with the objective of amortized cost classification, then, by definition, they would be consistent with that objective.

The ED also includes specialized terminology (e.g., “bespoke structured investment” in paragraph 825-10-55-18) that is not defined.

As discussed on page 12 of the recent FASB/Private Company Council Invitation to Comment, *Private Company Decision-Making Framework—A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (the PCDMF ITC), providing plain-English guidance is especially important for nonpublic entities and the CPA firms that serve them. Without clearer guidance, TIC is concerned that many constituents in the private entity arena will fail to understand key principles of the proposed ASU and will misapply the final standard.

TIC also suggests that the three classification categories be defined in the glossary and that, wherever possible, the text of the standard refer to Amortized Cost, FV-OCI or FV-N/I, as appropriate. TIC believes this would be preferable to cross-referencing to a paragraph number elsewhere in the Codification without a verbal description of the classification category.

Another TIC concern relates to the lack of specific guidance for nonfinancial entities. TIC's specific comments on the questions for respondents identify several areas where additional guidance would be helpful.

### QUESTIONS FOR RESPONDENTS—2/14/13 ED

**Question 1:** *Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments should be included or excluded from the guidance in this proposed Update and why?*

The ED seems to include short-term receivables and payables within its scope. However, it is unclear whether certain circumstances or transactions (such as subsequently factoring accounts receivable) would ever require receivables to be measured at fair value. TIC believes short-term receivables and payables should always be measured at amortized cost since an expected-cash-flow model is the measurement attribute that is relevant to users of private company financial statements.

As written, the ED would also apply to related party loans. Among private entities, the most common related party loans are those between the entity and its owner(s). It is unclear to TIC whether such loans would meet the contractual cash flow criterion since these arrangements are often very informal, with no written contract, and may have no specified due date or stated payments of principal and interest. However, if such loans are deemed to be uncollectible, the writeoff would be treated as a dividend and would never flow through the income statement.

Therefore, TIC recommends a scope exclusion for short-term trade receivables and payables and related party loans with owners. If the Board decides not to do so, TIC requests that examples be added to the final standard to address the accounting for factoring short-term receivables and related party loans from/to owners of a business. These are common transactions among nonpublic entities and should be specifically addressed in the standard to provide clear, relevant guidance for nonpublic entities.

**Question 11:** *Do the proposed amendments provide sufficient application guidance and illustrations on how to distinguish among the three business models, including determining whether the business model is to manage assets both to collect contractual cash flows and to sell? Do you agree with the proposed guidance provided to describe those business models? If not, why?*

TIC supports the proposed classification of a financial asset (that meets the cash flow characteristics criterion) at recognition into one of three subsequent measurement categories based on an entity's business model. TIC believes that measurement criteria based on the manner in which an entity manages its financial instruments is an appropriate, principles-based approach.

Paragraph 825-10-55-86 provides helpful examples of business model changes for entities in the financial services industry. However, no such examples are provided for

nonfinancial entities, which need straightforward guidance that would apply to their circumstances. The ED therefore fails to follow the guideline stated in the PCDMF ITC (page 13), as follows:

*Illustrative examples included in new guidance that apply to private companies should include common private company fact patterns.*

Therefore, TIC recommends that the Board provide additional guidance as to the most likely circumstances that would trigger a change in business model for a nonpublic, nonfinancial entity. Such guidance could be stated as:

*The acquisition of a new business line, a business combination or the disposition of a segment that results in a change in how the entity manages its financial assets is a change in business model.*

Although equally applicable to a financial services entity, the above example would be more meaningful for a nonfinancial entity because it excludes the specialized industry context and focuses on the key, generic factors that could cause a change in business model.

**Question 12:** *Should the classification and measurement model for financial instruments contain an explicit tainting notion or should it rely on the principle and exercise of professional judgment? Why?*

TIC believes the model should rely on the principle and exercise of professional judgment. The tainting notion in current GAAP is too rigid and does not provide a consistently logical outcome. Specifically, TIC agrees with the concern expressed in paragraph BC132, which describes the potential unintended consequences that result from the tainting rules. Preparers and auditors are very conscious of the current tainting rule. The potential effect of a tainted portfolio may indeed drive a preparer's selection of a business model, which defeats the purpose of having a broad, principles-based approach.

**Question 19:** *The proposed amendments would provide a practicability exception for measuring equity investments without readily determinable fair values that do not qualify for the practical expedient in paragraph 820-10-35-59 (that is, the net asset value per share expedient) and a one-step impairment model for all equity investments subject to the practicability exception. Do you agree with the proposed amendments? If not, why?*

TIC agrees with the proposed amendments. However, TIC believes additional guidance is necessary regarding the measurement of an equity investment without a readily determinable fair value that does not qualify for the practical expedient. Paragraph 825-10-35-17 states that such equity investments would be measured at their "cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical investment or a similar investment of the same issuer." TIC was uncertain about the effort that preparers would need to make to obtain

“observable price changes” and requests that an example for nonfinancial institutions be added to the final standard as to how this phrase should be interpreted and applied.

**Question 20:** *Should an entity evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income separately from the other deferred tax assets of the entity (rather than combined and analyzed together)? If not, why?*

No, TIC does not support a separate valuation allowance for nonpublic entities for deferred tax assets related to debt instruments with unrealized losses classified in other comprehensive income. Rather, TIC believes that a valuation allowance should be assessed on the aggregate amount of deferred tax assets. A requirement to separately track this valuation allowance introduces unnecessary complexity and would place a significant burden on private, nonfinancial entities. These entities would incur significant cost and would have to expend limited resources for information that is not fundamentally related to their core business operations and is therefore not relevant to their financial statement users.

Realization of a deferred tax asset ultimately depends on the existence of sufficient taxable income of the appropriate character in either the carryback or carryforward period. Management is already required to prepare an extensive analysis of both positive and negative evidence regarding the realization of the deferred tax asset. This analysis includes scheduling reversals of temporary differences, evaluating expectations of future profitability, determining the potential for refunds in the event of net operating loss carrybacks, and evaluating potential tax-planning strategies. Instituting a requirement for management to separately evaluate the realizability of a component of its deferred tax asset would only add to the complexity of an already complex process without sufficiently adding to the reliability of the outcome.

**Question 24:** *The proposed amendments would exempt nonpublic entities from parenthetical and footnote disclosures of fair value. Should nonpublic entities be required to parenthetically present fair value information on the face of the statement of financial position for financial instruments measured at amortized cost? If not, should fair value disclosures in notes to the financial statements be required for some or all nonpublic entities for financial instruments measured at amortized cost?*

TIC believes nonpublic entities should not be required to parenthetically present fair value information on the face of the statement of financial position or in the notes for financial instruments measured at amortized cost. Generally, a readily determinable fair value is not available for these instruments. In addition, users of private company financial statements have no interest in fair value for their purposes. They are only interested in the cash flow considerations related to these instruments.

**Question 26:** *The proposed amendments would require an entity to separately recognize in net income changes in fair value attributable to foreign currency gain or loss on foreign-currency-denominated debt securities measured at fair value through other comprehensive*

*income (see paragraphs 825-10-45-14 through 45-15). Is the proposed fair-value-based method provided for computing the foreign currency gain or loss component operable? If not, why? What would you propose instead?*

TIC does not support recognizing separately in net income the portion of the fair value change attributable to a foreign currency gain/loss on these instruments. The proposed requirement would add unnecessary complexity and cost for nonpublic entities since their financial statement users would not find such bifurcation meaningful.

**Question 31:** *Should the effective date be the same for both public entities and nonpublic entities?*

TIC believes nonpublic entities should be given an additional year to implement major standards, such as those involving financial instruments. Practitioners and preparers within TIC's constituency need additional time to become familiar with the standards and to evaluate the impact of the standard on the entity's operations. Early adoption should be permitted for those entities that are able to implement the standard on a timely basis.

#### **QUESTIONS FOR RESPONDENTS—4/12/13 PROPOSED AMENDMENTS ED**

**Question 2:** *Do you believe that all guidance related to financial instruments in various Topics in the FASB Accounting Standards Codification® (for example, Topics 310 and 470) should be consolidated into a single Topic?*

Yes, TIC believes all guidance related to financial instruments should be presented in a single topic. TIC agrees that related guidance from other sections should be moved into this ED with appropriate cross references from the subject-specific standards to this standard.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,



Karen Kerber, Chair  
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees