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Re: Proposed Accounting Standards Update: Financial Instruments – Overall; Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10)

The Accounting Principles and Auditing Standards Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") respectfully submits its comments on the referenced proposed ASU. The AP&AS Committee is the senior technical committee of CALCPA. CALCPA has approximately 40,000 members. The Committee is comprised of 53 members, of whom 47 percent are from local or regional firms, 27 percent are from large multi-office firms, 12 percent are sole practitioners in public practice, 10 percent are in academia and 4 percent are in international firms.

The Committee appreciates the opportunity to comment on the proposed Accounting Standards Update: Financial Instruments – Overall; Recognition and Measurement of Financial Assets and Financial Liabilities (Subtopic 825-10). Furthermore, the Committee acknowledges and appreciates the FASB's apparent efforts to converge the proposed ASU with the IASB's current proposal. However, we are disappointed that a greater level of convergence in this project has not been achieved. Both recognition and measurement models are essentially very similar. We believe either approach is acceptable, with neither being intellectually (or theoretically) superior to the other. We urge the Boards to converge on the remaining disparate issues so entities and users can have the benefit of one standard.

A failure of the Boards to coverage on this issue could create burdensome operational issues for multi-national entities subject to IFRS in some reporting jurisdictions and US GAAP in others. Two potentially different recognition and measurement requirements for the same local entity could be unduly expensive. While the adoption of IFRS requirements into US GAAP might be a solution, achievement of this is uncertain.

The following represents the Committee's responses to the Questions for Respondents in the proposed ASU, including those Questions posed regarding the consequential amendments proposed:

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?

Yes, the Committee agrees with the scope of financial instruments included in the proposed update.

Question 2: Do you agree with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9? If not, why? What would you propose instead?

Yes, the Committee agrees with the industry-specific specialized guidance scope exceptions in paragraph 825-10-15-9.

USERS ONLY Question 3: The proposed amendments would require an entity to classify financial assets into the appropriate subsequent measurement category (that is, at amortized cost, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at fair value with all changes in fair value recognized in net income) on the basis of the contractual cash flow characteristics of the instrument and the business model within which financial assets are managed. Does the classification of financial assets based on the cash flow characteristics and the business model assessment provide decision useful information? If yes, how will this classification influence your analysis of the entity? If not, why?

Not applicable.

Question 4: Do the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment? If not, why? What would you propose instead?

Yes, the proposed amendments appropriately convey the principle associated with the contractual cash flow characteristics assessment.

Question 5: The proposed amendments define principal as the amount transferred by the holder at initial recognition. Should the definition of principal be expanded to include repayment of the principal amount at maturity or other settlement? If so, what instruments would fail (or pass) the contractual cash flow characteristics criterion as a result of this change?

The Committee does not believe expanding the definition of "principal" to include repayment of the principal amount at maturity or settlement is appropriate or necessary. This is based in part because we believe the FASB's contemplation of "reasonable additional compensation" (included in the evaluation of a prepayment option) provides an appropriate basis for determining whether consideration provided at maturity or other settlement date is representative of initially contemplated prepayment risk (*i.e.*, compensation initially deducted from amounts initially transferred), other prepayment consideration (*i.e.*, fees paid at time of settlement) or another forms of consideration beyond the define scope of "principal" or "interest."

Question 6: Do the proposed amendments contain sufficient application guidance and illustrations on implementing the cash flow characteristics assessment? If not, why?

Generally, the Committee believes that the application guidance included in the proposed update is sufficient. However, in the context of our response to Question 5 above, an illustration or indicators of what may constitute "reasonable additional compensation" would assist in evaluating whether the Contractual Cash Flow Characteristics have been met.

Question 7: Should a financial asset with a contractual term that modifies the economic relationship (see paragraphs 825-10-55-17 through 55-20) between principal and interest be considered to contain cash flows that are solely payments of principal and interest? Should this be the case if, and only if, the contractual cash flows could or could not be more than insignificantly different from the benchmark cash flows as discussed in paragraph 825-10-55-19? If not, why? What would you propose instead?

The Committee believes the proposed guidance within 825-10-55-17 through 55-20 to be appropriate.

Question 8: Do the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship? If not, why?

The Committee believes the proposed amendments contain sufficient application guidance in paragraphs 825-10-55-17 through 55-20 on assessing a modified economic relationship. The term "insignificant" is used effectively elsewhere in GAAP and is undefined. It is generally understood that judgment is required when applying the term. In combination with the illustrations provided, the proposed guidance is adequate.

Question 9: For beneficial interests in securitized financial assets, the proposed amendments would require an entity to look through to the underlying pool of instruments in determining whether the tranche contains payments of solely principal and interest. Do you agree with this look-through approach? If not, why? What would you propose instead?

Yes. The Committee believes the look-through approach, as set forth within the proposed update, to be reasonable.

Question 10: Do the proposed amendments appropriately convey the principle associated with the business model assessment? If not, why? What would you propose instead?

Yes. The Committee believes the proposed amendments appropriately convey the principle associated with the business model assessment.

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?

Yes. The Committee agrees with the description of the business models proposed. We also believe the application guidance provided, including the illustrations, is adequate to distinguish between the three business models.

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?

Yes. The Committee agrees that an explicit tainting notion is not appropriate and may lead to "design-workarounds." We believe reliance on the principles conveyed and the application of professional judgment is appropriate. The term "very infrequent", like "insignificant", should be widely understood and capable of being applied. Furthermore, the expanded disclosure, including references to fair value and separate line disclosures of held to collect instrument sales, help mitigate the risks associated with financial statement misrepresentations and provide users relevant information necessary to assess the models employed by companies.

Question 13: The proposed amendments would require loan commitments, a revolving line of credit, or a commercial letter of credit (the potential creditor) to be measured on the basis of the likelihood of exercise of the commitment and the classification of the underlying loan that would be made upon exercise of the commitment. Do you agree with the proposed classification of loan commitments? If not, why? What would you propose instead?

Yes. The Committee believes measurement and classification approaches proposed for potential creditor loan commitments, revolving lines of credit, or commercial letters of credit are appropriate.

Initial Measurement

Question 14: Do you agree with the initial measurement principles for financial instruments? If not, why?

Yes. The Committee agrees with the initial measurement principles proposed.

Subsequent Measurement

USERS ONLY Question 15: The proposed amendments would eliminate the unconditional fair value option (for financial instruments within the scope of this proposed guidance) in existing U.S. GAAP and, instead, permit an entity to elect to measure at fair value, with all changes in fair value recognized in net income, all of the following:
a. A group of financial assets and financial liabilities if the entity both:
1. Manages the net exposure relating to those financial assets and financial liabilities (which may be derivative instruments) on a fair value basis
2. Provides information on that basis to the reporting entity's management.
b. Hybrid financial liabilities that meet certain prescribed criteria.
c. Financial assets that meet the contractual cash flow characteristics criterion and are managed within a business model that has the objective of both holding financial assets to collect contractual cash flows and selling financial assets (in accordance with paragraph 825-10- 25-25(b)).

Do these options provide decision-useful information? If not, why?

Not Applicable.

Question 16: Should financial liabilities subsequently be measured at amortized cost, unless certain exceptions are met? If not, why?

Yes, the Committee believes that financial liabilities should be measured at amortized cost, except in certain limited circumstances. We further believe the amortized cost exceptions proposed are appropriate.

Question 17: The proposed amendments would require a nonrecourse financial liability that is settled with only the cash flows from the related financial assets (see paragraph 825-10-35-11) to be measured on the same basis as those assets. Do you agree with the proposed amendments? If not, why? What would you propose instead?

The Committee generally agrees with the proposed amendments to require a nonrecourse financial liability (that is settled with only the cash flows from the related financial assets) be measured on the same basis as those assets. However, certain Committee members noted that such guidance may be inconsistent with existing accounting requirements where a nonrecourse financial liability is to be settled with only the proceeds generated from the sale of property. We are unaware as to whether the FASB contemplated this inconsistency during its deliberations and believe it appropriate to do so.

The Committee also believes that implementation guidance related to the subsequent measurement principles established within the proposal would be beneficial, particularly when nonrecourse financial liabilities, linked with financial assets, are measured at FV-OCI. Lastly, enhanced disclosures would be beneficial to issuers of financial statements. For example, if the actual debt obligation outstanding is reduced to reflect the fair value of the linked financial assets, it would be important to state that fact as well as the actual amount outstanding (in case of a potential recovery in the asset value).

Question 18: The proposed amendments would require financial assets measured at amortized cost that are subsequently identified for sale to continue to be classified and measured at amortized cost less Impairment and would prohibit recognition of the gain, until the sale is complete. Do you agree with the proposed classification and measurement requirements? If not, why?

Yes. The Committee agrees with the proposed classification and measurement requirements.

Question 19: The proposed amendments (825-10-35-17) 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?

Yes. The Committee agrees with the proposed amendments.

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?

While the Committee believes that the separate evaluation proposed within the exposure draft is appropriate, members believed that this particular issue is a tax accounting question, outside the scope of this project.

Question 21: Under the amendments in this proposed Update, hybrid financial assets would not be required to be analyzed for bifurcation under Subtopic 815- 15 and would be assessed in their entirety on the basis of the proposed classification requirements. In contrast, hybrid financial liabilities would be assessed for bifurcation and separate

accounting under Subtopic 815-15, and the financial liability host contract would be subject to the proposed amendments. Do you agree with this proposal? If not, why? What would you propose instead?

Yes. The Committee agrees with the proposed amendments.

Question 22: The proposed amendments (825-10-35-22) would require reclassification of financial assets when a change in business model occurs and prescribes how those changes should be subsequently accounted for. Do you agree with the proposed amendment on reclassifications? If not, why?

Yes. The Committee agrees with the proposed amendments on reclassifications.

Presentation

USERS ONLY Question 23: The proposed amendments would require public entities to parenthetically present fair value for items measured at amortized cost on the face of the statement of financial position. Does that presentation requirement provide decision-useful information? If not, why? What would you propose instead?

Yes. The Committee believes that the proposed parenthetical disclosures provide meaningful information.

USERS ONLY 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?

The Committee believes that nonpublic entities, as defined within the proposal, should generally be exempt from parenthetical and footnote disclosure of fair value. However, the Committee further acknowledged possible exceptions for nonpublic entities with a public interest. These entities include banking institutions and insurance companies. In these limited circumstances the Committee believes the parenthetical and footnote disclosure of fair value proposed for public entities may be useful and appropriate. It would be helpful to understand what if any outreach was performed by the FASB to assess the utility of such disclosures.

USERS ONLY Question 25: The proposed amendments would require an entity to separately present changes in fair value attributable to changes in instrument-specific credit risk in other comprehensive income for financial liabilities for which that entity has

elected the fair value option. Would the proposed presentation requirement provide decision-useful information? If not, why? What would you propose instead?

Not applicable.

PREPARERS AND AUDITORS ONLY 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?

Yes. The Committee generally believes the proposed fair-value based method is operational. However, the Committee questions whether the information is useful

Disclosures

USERS ONLY Question 27: The proposed amendments would require a public entity to provide disclosure of the core deposit liability balance, implied weighted-average maturity period, and the estimated all-in-cost-to-service rate by significant type of core deposit liability. Do you agree with the proposed disclosure requirement and, if so, how would you use that information? If not, what information should be provided and why? Is it appropriate not to require this information for nonpublic entities?

Not applicable.

USERS ONLY Question 28: Are there any other disclosures that would provide decision-useful information and why?

Not applicable.

Question 29: Do you agree with the proposed disclosure requirements? If not, which disclosure requirement would you change and why?

Yes. The Committee agrees with the proposed disclosure requirements.

Transition and Open Effective Date Information

Question 30: Should an entity be permitted to early adopt only the proposed presentation requirements related to changes in instrument-specific credit risk for hybrid financial

liabilities that would qualify for the fair value option under the proposed requirements? If not, why?

Yes. The Committee believes early adoption for only the proposed presentation requirements (related to changes in instrument-specific credit risk for hybrid financial liabilities that would qualify for the fair value option) is appropriate.

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

No. The Committee believes that consistent with the FASB's practice, nonpublic companies should be provided an additional year for adoption.

PREPARERS AND AUDITORS ONLY Question 32: How much time is needed to implement the proposed guidance?

The Committee believes the direct outreach from public companies would provide more decision useful information to appropriately respond to this question.

PREPARERS AND AUDITORS ONLY Question 33: Are the transition provisions in this proposed Update operable? If not, why?

Yes. The Committee believes the transition provisions in this proposal are operable.

Equity Method Accounting

Question 34: The proposed amendments would require investments that qualify for the equity method of accounting in Subtopic 323-10, Investments—Equity Method and Joint Ventures—Overall, to be subsequently measured at fair value with changes in fair value recognized in net income if the investment is held for sale at initial recognition (323-10-35-31A). Are the proposed indicators/conditions operable? If not, why? What would you propose instead?

Yes. The Committee agrees with the proposal and believes the indicators/conditions included are operable.

Proposed implementation guidance

Question 35: The proposed amendments would change the current two-step impairment model for equity method investments to a one-step impairment model for all equity

investments. Do you agree with the proposed one-step equity impairment model? If not, why? What would you propose instead?

Yes. The Committee agrees with the proposed one-step impairment model as contemplated within the exposure draft.

Question 36: Do you agree that the current portfolio-wide option for not-for-profit entities, other than health care entities, to account for their equity method investments at fair value should be retained? If not, why? Should that option also be made available to not-for-profit health care entities that are within the scope of Topic 954, Health Care Entities?

Yes. The Committee agrees that the current portfolio-wide option for non-for profit entities, other than health care entities, to account for their equity method investments at fair value should be retained.

Nonfinancial Hybrid Instruments

Question 37: The proposed amendments would eliminate the fair value option for hybrid nonfinancial instruments in current U.S. GAAP and would provide a new fair value option for hybrid nonfinancial liabilities. For a hybrid nonfinancial liability, an entity would apply the bifurcation and separate accounting requirements in Subtopic 815-15 and account for the embedded derivative in accordance with Topic 815. The financial liability host that results from separation of the nonfinancial embedded derivative would be subject to the proposed amendments. However, an entity would be permitted to initially and subsequently measure the entire hybrid nonfinancial liability at fair value (with changes in fair value recognized in net income) if after applying Subtopic 815-15 the entity determines that an embedded derivative that requires bifurcation and separate accounting exists. In contrast, for a hybrid nonfinancial asset the proposed amendments would require the hybrid contract to be measured at fair value (with changes in fair value recognized in net income) if the hybrid nonfinancial asset contains an embedded derivative that would have required bifurcation and separate accounting under Subtopic 815-15. Do you agree with the proposed amendments? If not, why? What would you propose instead?

Yes. The Committee agrees with the proposed amendments.

Proposed amendments to the FASB Accounting Standards Codification April 12, 2013

Questions for All Respondents

Question 1: Do you believe that the proposed consequential amendments that would result from the proposals in the proposed Update on financial instruments have been appropriately reflected? If not, what alternative amendment(s) do you recommend and why?

Yes. The Committee believes that the consequential amendments are appropriately reflected within the proposed Update.

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. The Committee believes the utilization of one Topic for financial instruments might make the Codification easier to work with.

Question 3: The proposed amendments also would eliminate the fair value option (for financial instruments not within the scope of the proposed Update on financial instruments) in current U.S. GAAP (see paragraph 825-10-15-4), related to guarantees, contingencies, rights and obligations of insurance contracts and warranties, written loan commitments, and firm commitments. Do you agree with the proposed elimination and the effective date and transition guidance? If not, why? What would you propose instead?

We support the proposed amendments, provided the Update is not effective until after other proposed Updates (e.g., insurance contracts and revenue recognition) become effective.

We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Very truly yours,

Michael D Feinstein

Michael D. Feinstein, Chair
Accounting Principles and Auditing Standards Committee
California Society of Certified Public Accountants