



December 19, 2013

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

File Reference No. EITF-13G

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on *FASB Proposed Accounting Standards Update—Derivatives and Hedging—Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity (Topic 815)*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments on the proposed Accounting Standards Update (the ED) 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.

Our Committee supports the Board's efforts to resolve the diverse approaches for analyzing hybrid financial instruments issued in the form of a share and encourages the Board to extend this approach to hybrid debt instruments. Our Committee strongly believes that no single feature should be determinative in concluding whether the host contract is more akin to debt or to equity. We firmly support analysis of the host contract by considering all stated and implied substantive terms and features of the hybrid financial instrument, and by considering each term and feature on the basis of the relevant facts and circumstances. The proposed amendments may result in diversity in the application of the Whole Instrument approach. We believe that such diversity is warranted based on the substantive features and the economic characteristics and risks of the entire hybrid financial instrument. We do not think diversity will result from the approach itself.

Our responses to the "Questions for Respondents" are below:

**Question 1: Should the scope of the proposed amendments be extended beyond hybrid financial instruments issued in the form of a share? If yes, please explain why and identify other hybrid instruments that should be considered by the Task Force.**

We believe that the scope of the proposed amendments is appropriate and should not be extended beyond hybrid financial instruments issued in the form of a share. We believe that it would be helpful (see below) if the FASB provided indicators of whether features are debt-like or equity-like, including but not limited to noncontingent fixed price redemption features. These indicators would be helpful in analyzing features embedded in both debt and equity hosts.

**Question 2: Do you agree that a reporting entity should consider all terms and features—including the embedded derivative feature being evaluated for bifurcation—when determining whether the nature of a host contract is more akin to debt or to equity? If another method should be used, please explain that method and why it would be an improvement.**

We believe that Whole Instrument is the appropriate approach for analyzing features embedded in host contracts. We believe that the Chameleon approach could generate unusual, perhaps confusing, results since the host instrument could be considered either debt-like or equity-like depending on the embedded feature being removed from the host for analysis. The end result of the potentially confusing results generated by the Chameleon approach is that in our experience, its use by issuers, has been very limited. We believe that mandating the Whole Instrument approach will ensure that the analysis of embedded features is consistent from instrument to instrument.

**Question 3: Do you agree that no single feature should be determinative in concluding whether the host contract is more akin to debt or to equity? Furthermore, do you agree that a fixed-price, noncontingent redemption option held by an investor embedded in a share is not, in and of itself, determinative in concluding that the nature of the host contract is more akin to debt? If not, please explain why.**

We agree that no single feature should be determinative in concluding whether the host contract is more akin to debt or to equity. We note that there are a limited variety of host contracts with embedded features based on the International Swaps and Derivatives Association, Inc. Master Agreement and Equity Derivatives Definitions (the ISDA contracts), and these contracts in general can be more easily identified as either debt or equity hosts. However, there are an almost infinite variety of host instruments with embedded features that are negotiated by private equity firms and other investors that are *not* based on ISDA contracts, and it is these contracts that present a significant challenge in being identified as either a debt or an equity host.

We believe that in order to analyze each host instrument properly, especially the instruments that are not based on the ISDA contracts, the ED paragraph 815-15-25-17A appropriately states:

“...an entity shall determine the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid financial instrument, considering each term and feature on the basis of the relevant facts and circumstances. That is, in determining the nature of the host contract, an entity shall consider the economic characteristics and risks of the entire hybrid financial instrument including the embedded derivative feature that is being evaluated for potential bifurcation. ... For example, an entity shall not presume that the presence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock contract, in and of itself, determines whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument. Rather, the nature of the host contract depends on the economic characteristics and risks of the entire hybrid financial instrument.”

We agree that a fixed-price noncontingent redemption option held by an investor embedded in a share is not, in and of itself, determinative in concluding that the nature of the host contract is more akin to debt. The example in paragraph 815-15-25-17A regarding the presence of a fixed-price, noncontingent redemption feature *may* introduce new diversity in the application of the Whole Instrument approach. We believe that such diversity is warranted based on the instrument’s substantive features and the economic characteristics and risks of the entire hybrid financial instrument. We do not think the diversity will result from the approach itself.

We believe that it would be helpful for the FASB to develop indicators of debt-like and equity-like features. The example in 815-15-25-17A is helpful, but we encourage the FASB, as it continues to work on debt and equity, to develop more examples and indicators of debt and equity hosts.

**Question 4: Will the proposed amendments help reduce diversity in practice with respect to determining the nature of the host contract within hybrid financial instruments issued in the form of a share? If not, please explain why.**

As indicated above, our experience has been that the approach prescribed in the ED is the method predominantly used in current practice. We believe that the proposed amendments will help reduce the diversity in methods that may be applied in evaluating the nature of the host contract. We believe that the conclusions reached regarding whether the host is debt or equity may differ. However, we believe that these differences will be properly based on the instruments' substantive features and the economic characteristics and risks of the entire hybrid financial instrument.

**Question 5: Do you agree that the effects of the proposed amendments should be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the annual reporting period in which the proposed amendments are effective? Do you further agree that retrospective application should be allowed?**

We agree with providing entities a choice of applying the proposed amendments on a modified retrospective or full retrospective basis. We would also find it acceptable to provide entities an additional option to apply the proposed amendments prospectively.

Paragraph 815-15-65-2d provides that if an entity is no longer required to bifurcate an embedded derivative feature as a result of applying the amendments in the ED, the carrying amount of the related hybrid financial instrument at the effective date should be the total carrying amount of the host contract and the fair value of the previously bifurcated embedded derivative feature. We believe that this provision would ease transition as no separate measurement would be necessary for the entire hybrid instrument, and applaud this provision.

**Question 6: Do you agree that an entity should be permitted to early adopt the proposed amendments? If not, please explain why.**

We agree.

**Question 7: The proposed amendments would apply to public and nonpublic entities. Should the proposed amendments be different for nonpublic entities? If so, please describe how and why you think they should be different.**

We believe that the guidance should apply to both public and private entities.

**Question 8: How much time would be needed to implement the proposed amendments and would the implementation period differ for nonpublic entities versus public entities? Please explain why.**

We note that transition paragraph 815-15-65-2 provides that if an entity is required to bifurcate an embedded derivative feature as a result of applying the amendments in the ED, the carrying amount of the host contract at the effective date should be based on the assumption that the embedded derivative feature had been bifurcated as of the date the entity issued or acquired the hybrid financial instrument. The application of the ED on a retrospective or modified retrospective basis may require considerable time and effort. We are

unable to estimate the time needed to implement the proposed amendments on a retrospective or modified retrospective basis, but do not believe that a short implementation period is appropriate.

We have no objection if the Board wishes to provide a delayed effective date for the guidance in this ED for private entities as it has on other ASUs.

We appreciate the opportunity to offer our comments.

Sincerely,

**Scott G. Lehman, CPA**  
Chair, Accounting Principles Committee

**Amanda M. Rzepka, CPA**  
Vice-chair, Accounting Principles Committee

## APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE  
ORGANIZATION AND OPERATING PROCEDURES  
2013-2014

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	Grant Thornton LLP
Todd Briggs, CPA	McGladrey LLP
Brian Chmiel, CPA	Crowe Horwath LLP
Frank Dery, CPA	PricewaterhouseCoopers LLP
John Hepp, CPA	Grant Thornton LLP
David Jamiolkowski, CPA	Baker Tilly Virchow Krause, LLP
Scott Lehman, CPA (Chair)	Crowe Horwath LLP
Elizabeth Prossnitz, CPA	BDO USA LLP
Robert Sledge, CPA	KPMG LLP

**Medium:** (more than 40 professionals)

Timothy Bellazzini, CPA	Sikich LLP
Christopher Cameron, CPA	Kutchins Robbins & Diamond Ltd
Michael Kidd, CPA	Mowery & Schoenfeld LLC
Gary Mills, CPA	Frost, Ruttenberg & Rothblatt PC
Tad Render, CPA	Miller Cooper & Company Ltd
Steven Roiland, CPA	FGMK, LLC
Jeffery Watson, CPA	Miller Cooper & Company Ltd

**Small:** (less than 40 professionals)

Peggy Brady, CPA	Selden Fox, Ltd.
Brian Kot, CPA	Cray Kaiser Ltd CPAs

**Industry:**

Rose Cammarata, CPA	CME Group Inc.
Farah Hollenbeck, CPA	Abbvie Inc.
Joshua Lance, CPA	N Pritzker Capital Management LLC
Marianne Lorenz, CPA	AGL Resources Inc.
Michael Maffei, CPA	GATX Corporation
Anthony Peters, CPA	McDonald's Corporation
Amanda Rzepka, CPA (Vice Chair)	Jet Support Services, Inc.
Richard Tarapchak, CPA	Navistar International Corporation

**Educators:**

Martin Coe, CPA	Western Illinois University
James Fuehrmeyer, Jr., CPA	University of Notre Dame

**Staff Representative:**

Gayle Floresca, CPA	Illinois CPA Society
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