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December 18, 2018

Via email to director@fasb.org

Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Codification Improvements—Financial Instruments (File Reference No. 2018-300)

Dear Ms. Cospers:

We are pleased to provide our comments on the Board's proposal to clarify and improve the recently issued standards on credit losses and hedging, as well as the recognition and measurement of financial instruments. We support the Board's ongoing projects to improve the Codification and clarify its application, including in response to implementation issues in these areas.

Our responses to the Board's specific questions, along with our suggestions, are provided in Appendix A to this letter.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Gautam Goswami at (312) 616-4631, Tim Kviz at (703) 245-8685 or Brad Bird at (312) 730-1294.

Very truly yours,

A handwritten signature in black ink that reads "BDO USA, LLP". The letters are written in a cursive, slightly slanted style.

BDO USA, LLP

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Appendix A

Topic 1: Codification Improvements Resulting from the June 11, 2018 Credit Losses TRG Meeting Issue 1A: Accrued Interest

Question 1: Will the amendments in this proposed Update to (a) measure expected credit losses on accrued interest separately from other components of amortized cost basis, (b) make an accounting policy election to present accrued interest amounts separately from the related loan balance, and (c) elect a practical expedient to separately disclose the total amount of accrued interest included in amortized cost basis as a single balance to meet certain disclosure requirements simplify and reduce operational concerns when implementing the guidance in Update 2016-13 related to accrued interest? If not, please explain why you disagree and what changes should be made instead.

We believe the amendments in the proposed update to (a) measure expected credit losses on accrued interest separately from other components of amortized cost basis, (b) make an accounting policy election to present accrued interest amounts separately from the related loan balance, and (c) elect a practical expedient to separately disclose the total amount of accrued interest included in amortized cost basis as a single balance to meet certain disclosure requirements will both simplify and reduce operational concerns when implementing the guidance in Update 2016-13 related to accrued interest.

Question 2: Do you support the separate accounting policy elections that would allow an entity to choose to (a) write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses and (b) elect not to measure an allowance for credit losses on accrued interest if the entity writes off uncollectible accrued interest amounts in a timely manner? If not, please explain why you disagree and what changes should be made instead.

We support both the separate accounting policy elections that would allow an entity to choose to (a) write off accrued interest amounts by either reversing interest income or adjusting the allowance for credit losses and (b) elect not to measure an allowance for credit losses on accrued interest if the entity writes off uncollectible accrued interest amounts in a timely manner. However, considering the multiple policy elections referred to here and in Question 1 above, we believe another alternative is for the Board to redeliberate amending the amortized cost basis definition to exclude accrued interest. We observe such exclusion would have a similar effect as availing all the referred elections.

Question 3: If you agree with the policy election not to measure an allowance for credit losses on accrued interest if the entity reverses or writes off uncollectible accrued interest amounts in a timely manner, what period would you consider to be timely?

We believe that the proposed amendments should permit existing practice to be maintained, and accordingly current industry standards for the various loan types should be permissible. We suggest acknowledging in the Basis for Conclusions that financial institutions following the write off guidance required by banking regulators would be considered timely for GAAP reporting purposes. We believe it also will be helpful to reiterate that the amendments are not intended to change the principle that a write-off should be recorded in the period that a financial asset is deemed uncollectible. Such clarification may assist other entities in developing their own policies, including analogizing to other acceptable policies such as that for financial institutions. We do not believe that a bright-line time period needs to be established.

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Issue 1B: Transfers between Classifications or Categories for Loans and Debt Securities

Question 4: Are the proposed amendments related to the transfer of loans and debt securities between classifications or categories operable? If not, please explain why you disagree and what changes should be made instead.

We believe the proposed amendments would be operable. We also observe that the proposed amendments would require an entity to present on a gross basis on the face of the income statement or in the notes to financial statements, the amounts reversed or established for the allowance for credit losses related to the transfer of debt securities between categories in proposed paragraph 320-10-45-8B. We do not have any concerns with this flexibility; however, we question whether disclosing the gross amount provides decision-useful information to users of the financial statements. We observe the amounts reversed would be stale as it would represent the amount from the prior period end (e.g., 3 months for issuer entities and up to 12 months old for companies providing financial statements on an annual basis). We believe that presenting net transfers in the footnotes may provide more useful information. The information could be presented in the notes to the financials in the rollforward of the related allowance where a line item could be added to present changes recognized due to transfers between classifications or categories. However, we acknowledge that users are better placed to comment on the information and manner of presentation they would consider relevant.

Issue 1C: Recoveries

Question 5: Do the proposed amendments clarify that recoveries are inputs that should be considered when measuring the allowance for credit losses? If not, please explain why you disagree and what changes should be made instead.

We generally agree that the proposed amendments clarify that recoveries are inputs that should be considered when measuring the allowance for credit losses. We believe the wording proposed in 326-20-30-1 could be clarified. Therefore, we recommend the following changes to clarify the Board's intended approach (additions underlined):

"Expected recoverable amounts shall be included in the valuation account, but shall not exceed the aggregate..."

We acknowledge the disclosure requirement as written should result in an understanding of how recoveries are considered in the model. However, we suggest for further clarity that the Board specifically add a disclosure requirement related to an entity's estimate under paragraphs 326-20-50-10 and 50-11 whereby an entity disclose the nature of recoveries considered in the measurement of expected credit losses. That is, the source of recoveries should be disclosed whether it is expected cash flows from the borrower, expected cash flows from the underlying collateral, expected cash flows from attached credit enhancements, or from expected sales of defaulted receivables (or any or all of the above). We believe those inputs may be important for users of the financial statements to assess comparability of the allowance for credit losses among entities.

In the proposed guidance, if an entity acquires loans in default, the individual loans may be charged off, as they are deemed uncollectible; however, the incorporation of expected recoveries would be recognized as a negative allowance. This essentially establishes another model outside of the PCD model for acquired credit deteriorated assets that does not apply at the individual loan level. Therefore, we believe it would be beneficial to specify in the proposed amendments or in the Basis for Conclusions whether application of that negative allowance model in lieu of the PCD model is consistent with the Board's intent. We believe the Board should also clarify whether the PCD disclosures e.g., those in paragraph 326-20-50-13(c), etc. would still apply when an entity applies the "negative allowance model" to acquired credit-deteriorated assets.

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Question 6: Do the proposed amendments clarify that an entity may record a negative allowance when measuring the allowance for credit losses using the fair value of the underlying collateral in accordance with paragraphs 326-20-35-4 through 35-5?

Generally, yes.

However, we believe as currently written, the language regarding “at the reporting date” could be misinterpreted. That guidance could be read two different ways:

- When foreclosure is probable, the measurement of expected losses should consider the value of the collateral when the entity expects to foreclose on the collateral (i.e., the forward rate), or
- When foreclosure is probable, that the measurement of expected losses should include the fair value of the collateral as of the reporting date (i.e., the spot rate).

Because the standard considers not just past events and current conditions, but also reasonable and supportable forecasts, we would expect that the value of the collateral reflect the forward rate. For example, when foreclosure of a residential mortgage is probable, but foreclosure is not expected to occur for 12 months (e.g., in a state with extended judicial foreclosure proceedings) and housing prices are declining, the value of the collateral should be based on the forward rate, i.e., 12 months in the future. It could go the other way as well in a rising price environment that could result in a smaller loss upon actual foreclosure. Therefore, we believe it would be helpful for the Board to clarify that the value of collateral is intended to reflect the forward rate.

In contrast, if the Board believes the collateral-dependent fair value approach is an exception to CECL, and therefore, should reflect a current exit price despite the fact that the spot rate may not reflect the entity's expected cash receipts, this should be clarified.

Question 7: Should an entity be permitted to record a negative allowance when measuring the allowance for credit losses on available-for-sale debt securities? If yes, why?

We believe an entity be permitted to record a negative allowance when measuring the allowance for credit losses on available-for-sale debt securities because it is consistent with the basic principle that the allowance should be used to adjust for the amount of expected collections.

Topic 2: Codification Improvements to Update 2016-13

Question 8: Do the proposed amendments clarify the guidance in Update 2016- 13? If not, please explain which proposed amendment(s) you disagree with and why.

We agree that the amendments in the proposed Update would provide additional clarity about the intended application of ASU 2016-13.

Question 9: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.

We believe the Board should clarify that receivables from freestanding credit enhancements that are neither derivatives under Topic 815 nor insurance transactions under Topic 944 are also within the scope of the CECL model. Otherwise, it may be unclear what model they should follow and why another model would be more appropriate than CECL.

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We also recommend clarifying in the guidance (or in the basis for conclusions) that prepay adjusted EIR contemplates all situations where the loan balance is reduced to zero prior to contractual maturity, i.e., both voluntary and involuntary scenarios. Specifically, when determining the EIR, prior write-offs of principal (i.e., charge-off basis adjustments) need to be excluded from the calculation. Otherwise, this will have the effect of double counting the loss, i.e., once when the write down occurs and again through the discount rate on the remaining cash flows expected to be collected.

Question 10: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

We do not believe that the proposed amendments require special consideration for nonpublic entities.

Question 11: Should an entity be required to use a prepayment-adjusted effective interest rate if it uses projections of interest rate environments in estimating expected cash flows, including expected prepayments and defaults?

We agree an entity should be required to use a prepayment-adjusted effective interest rate if it projects interest rate environments in estimating expected cash flows, including expected prepayments and defaults. We see no conceptual basis to incorporate one, but not the other.

Question 12: How much time would be needed to implement the proposed amendments for an entity that has already adopted Update 2016-13 before these proposed amendments are finalized? What transition method and transition disclosures should be required when adopting these proposed amendments and why?

We generally believe early adopters would not need any significant additional time to implement these proposed amendments. However, early adopters may have additional feedback on this question, including transition methods for the various amendments.

We support providing flexibility in transition methods, so as to not penalize those entities that early adopted, and would look to preparer input on this question. We do not believe any additional disclosures beyond the standard requirements applicable to a change in accounting principle would be necessary upon transition.

Question 13: Should the effective date and transition requirements for the amendments in this proposed Update align with that of Update 2016-13 for entities that have not yet adopted Update 2016-13 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?

We believe it generally would be preferable for the effective dates of this proposed Update to align with the effective dates in ASU 2016-13. However, entities may need additional time to comply with the final amendments. This will depend on when the proposed Update is finalized compared to the effective dates in ASU 2016-13 and the extent to which preparers will need to update their processes, systems and controls as a result of the final standard.

We believe entities should also be provided with a transition method similar to that provided in ASU 2016-13 so as to not penalize those entities that early adopted. We do not believe any additional disclosures beyond the standard requirements would be necessary upon transition.

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Topic 3: Codification Improvements to Update 2017-12 and Other Hedging Items

Question 14: Do the proposed amendments clarify the guidance in Topic 815? If not, please explain which proposed amendment(s) you disagree with and why.

We believe the proposed amendments clarify the guidance in Topic 815 and better align the accounting for hedging relationships with the economics of the transactions. For instance, allowing a single financial instrument to be hedged by one or more separately designated partial-term fair value hedging relationships at the same time may better align with an entity's risk management strategy than current guidance.

Question 15: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the proposed Codification improvements related to (a) the change in hedged risk guidance for cash flow hedges discussed at the March 28, 2018 Board meeting and (b) use of the word prepayable in the shortcut method guidance discussed at the February 14, 2018 Board meeting will be included in a future proposed Update.

We don't believe any other changes should be made to the proposed amendments. However, we believe clarifying the following would assist in implementation:

- (a) Considering that forward starting swaps may be a common instrument for hedging later dated terms (e.g., interest in Years 4 and 5 of a 5-year debt instrument) in partial term hedges, whether the qualitative "shortcut" method in paragraph 815-20-25-102 can be applied to such instruments. We observe that the Simplified Hedge Accounting Approach allows for forward starting swaps in paragraph 815-20-25-138, but the shortcut method does not have similar explicit guidance in this regard.
- (b) Further, considering that many entities may wish to apply qualitative methods (instead of a quantitative method) to assess hedge effectiveness, whether the guidance in paragraph 815-20-25-84A about an entity being allowed to assume that the hedged transaction and the hedging instrument match if they occur/mature within the same 31-day period or fiscal month also can be applied to hedges of interest rate risk. For instance, whether in assessing effectiveness of hedges of interest rate risk, any differences in key terms of up to 31 days, such as an interest rate reset or payment date differing by less than a month could still be assumed to be perfectly matched.
- (c) The proposed amendments would clarify that an entity may, but is not required to, begin to amortize a fair value hedge basis adjustment before the fair value hedging relationship is discontinued. Considering that the proposed amendments will also allow for multiple separately designated partial-term hedging relationships to be outstanding at the same time for the same debt instrument, can an entity apply different amortization methods to each of these separately designated hedges, even if they all relate to the same debt instrument?

Question 16: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

Considering that application of hedge accounting is an election, we do not believe the proposed amendments require special consideration for nonpublic entities.

Question 17: Should partial-term fair value hedging be expanded to all risks eligible for hedge accounting?

We believe partial-term fair value hedging should be expanded to all risks eligible for hedge accounting as that may better align the accounting with the economics of the hedging transaction and an entity's risk management strategy.

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Question 18: Do you agree with the specific considerations for transition and the effective date for the proposed amendments to Topic 815? Please explain why or why not.

We agree with the proposal and its basis for conclusions regarding specific considerations for transition and the effective date for the proposed amendments to Topic 815.

Question 19: Should the proposed amendments to Topic 815 be effective as of the earlier of the beginning of the first quarterly period (if applicable) or the first annual period after the issuance date of a final Update? Would this provide entities with sufficient time to implement these amendments?

We believe the proposed amendments should be effective as of the beginning of the first annual period after the issuance date of a final Update but allow for early adoption. We believe this adoption timeline provides entities with flexibility to efficiently and effectively adopt the new standard.

Topic 4: Codification Improvements to Update 2016-01

Question 20: Do the proposed amendments clarify the guidance in Update 2016-01? If not, please explain which proposed amendment(s) you disagree with and why.

We believe the proposed amendments clarify the guidance in Update 2016-01. However, we note that preparers may have additional input on whether applying Topic 820 to the measurement alternative as clarified in Issue 4C would be cost-effective.

Question 21: Are there other changes that should be made that are directly or indirectly related to the proposed amendments? Please note that the Board will conduct Codification improvement projects on a periodic basis and additional changes may be postponed to a subsequent Codification improvement project.

We do not believe there are other changes that should be made that are directly or indirectly related to the proposed amendments.

Question 22: The proposed amendments would apply to public and nonpublic entities. Would any of the proposed amendments require special consideration for nonpublic entities? If so, which proposed amendment(s) would require special consideration and why?

We do not believe any of the proposed amendments would require special consideration for nonpublic entities.

Question 23: How much time would be needed to implement the proposed amendments for an entity that has already adopted Update 2016-01 before these proposed amendments are finalized? What transition method and transition disclosures should be required when adopting the proposed amendments and why?

We believe the proposed amendments should be effective upon issuance and the transition method and related disclosures should mirror those released within Update 2016-01.

Question 24: Should the effective date and transition requirements for the proposed amendments align with that of Update 2016-01 for entities that have not yet adopted Update 2016-01 before these proposed amendments are finalized? What transition disclosures should be required when adopting the proposed amendments and why?

For entities that have not yet adopted ASU 2016-01, we believe the effective date and transition requirements for the proposed amendments should align with that of Update 2016-01. Considering the nature of the proposed amendments, we do not believe any incremental transition disclosures beyond those specified in ASU 2016-01 are necessary.

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Topic 5: Codification Improvements Resulting from the November 1, 2018 Credit Losses TRG Meeting

Question 25: Do the proposed amendments clarify how an entity should present line-of-credit arrangements that convert to term loans within the vintage disclosure table requirement in paragraph 326-20-50-6? If not, please explain which proposed amendment(s) you disagree with and why.

We do not believe the proposed amendments completely clarify how an entity should present line-of-credit arrangements that convert to term loans within the vintage disclosure table requirement in paragraph 326-20-50-6A. Specifically, the proposed language in the last sentence of paragraph 326-20-50-6A states "An entity shall disclose each reporting period, by class of financing receivable or major security type, the amount of line-of-credit arrangements that are converted to term loans each reporting period." It is not clear if the disclosure requirement is the number of arrangements that converted, and/or the dollar amount of loans converted.

Additionally, we do not believe most organizations track this information at this level of detail. Assumptions may need to be made by loan type. We suggest the Board conduct additional outreach with preparers to understand whether this information is readily available and if not, whether the cost outweighs the benefit of providing this information.

We conceptually agree with presenting line-of-credit arrangements that are converted to term loans based on whether a subsequent credit decision was made by the entity. However, we question whether entities, including smaller institutions, track, monitor and, importantly, retain this information in formalized systems. Considering the nature of the disclosure, we would not object if entities are provided a policy election to present such information in the separate column as illustrated in Example 15 of the proposal, regardless of whether another credit decision occurred subsequent to the original underwriting.

Question 26: Do the proposed amendments clarify how an entity should consider extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity? If not, please explain which proposed amendment(s) you disagree with and why.

We agree that the proposed amendments clarify how an entity should consider extension or renewal options that are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.