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American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

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

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The Financial Reporting Executive Committee (FinREC) appreciates the opportunity to comment on the Private Company Council's Proposed Accounting Standards Update (ASU), "Derivatives and Hedging (Topic 815) – Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps."

Overall, we support the FASB's efforts to simplify the accounting for hedges using certain receive-variable, pay-fixed interest rate swaps for private companies. However, we also see merit in expanding the simplified hedge accounting approach beyond the private company sector. We believe that other entities, such as not-for-profits, and certain insurance companies and financial institutions (which do not frequently engage in more complex transactions) would also benefit from this simplified approach.

Similar to private companies, many of these entities currently do not utilize hedge accounting because of the accounting complexities that come along with its application. Creating a more simplistic approach may allow more entities to consider hedging as a viable option. Furthermore, we believe that even some public companies that only use these types of swaps to manage their interest rate risk could benefit. We believe that the FASB should consider providing this simplified approach not only to private companies, but other companies with similar risk profiles that are also looking for appropriate accounting relief in this area. However, because immediate relief is needed for nonpublic companies, perhaps the FASB should move forward with this proposal and subsequently consider whether the approach under this proposal should be broadly applicable as part of its overall project on hedging financial instruments.

We are concerned with the proposed combined instrument approach. While it greatly simplifies the accounting for these plain vanilla instruments, allowing an entity to not record the swap separately reduces the transparency of the transaction for users of financial statements. Given the lessons learned from the recent credit crisis, we do not endorse loosening the accounting standards in this controversial area. FASB's proposed simplified hedge accounting approach is a great alternative that will give private companies the needed relief for accounting for these instruments. Therefore, we urge the FASB to move forward with the simplified hedge approach but not move forward with the combined instrument approach.

We also note public companies that apply the equity method under ASC 323, *Investments: Equity Method and Joint Ventures,* to private entities electing this alternative will be impacted in their recognition of equity in earnings or losses from such investees. We believe the Board should consider whether guidance should be provided for public companies that might be impacted by this, and other private company alternatives, in their application of the equity method to investees that make alternative elections as private companies.

We are providing our specific comments to the questions raised in the proposal. Representatives of FinREC would be pleased to discuss our comments with you at your convenience.

Sincerely,

Richard Paul
Chairman, FinREC

Mark Scoles,
Task Force Chairman

Questions for Respondents

Question 2:

Do you agree that the scopes of both the combined instruments approach and the simplified hedge accounting approach should exclude financial institutions described in paragraph 942-320-50-1, such as banks, savings and loan associations, savings banks, credit unions, finance companies, and insurance entities? If not, please explain why. Are there any other entities that should be excluded? (See also Question 3 below.)

Response:

We believe there is merit in extending the simplified hedge approach more broadly. Financial institutions and insurance companies potentially could use these forms of plain vanilla instruments as a tool in their risk mitigation strategy, but may not be applying hedge accounting because of the current complexity. Rather than considering extending the scope within this proposal, we believe that those discussions should be held as part of the financial instrument hedging project. More outreach is needed between FASB, the banking and insurance regulators, and the banking and insurance community. Because nonpublic companies appear to be in need of immediate relief, we believe that this project should be not delayed while FASB solicits further input on this issue.

We are concerned with the proposed combined instrument approach. While it greatly simplifies the accounting for these plain vanilla instruments, allowing an entity to not record the swap separately reduces the transparency of the transaction for users of financial statements. Therefore, we recommend that the Board abandon this approach.

Question 3:

Should the Board consider expanding the scope of either the combined instruments approach or the simplified hedge accounting approach (or both) to other entities, such as publicly traded companies or not-for-profit entities? If the scope is expanded to other entities, what changes, if any, should the Board consider for these approaches? Please explain why.

Response:

We believe that the simplified hedge accounting approach should be extended to not-for-profit entities. Furthermore, we believe that even some public companies that only use these types of swaps to manage their interest rate risk could benefit. However, we believe that the combined instrument approach should not be extended to any entities (see our response to Question 2).

Question 4:

Do you agree with the required criteria for applying the combined instruments approach and the simplified hedge accounting approach respectively? If not please explain why.

Response:

As stated in Question 2, we do not support the combined instrument approach. However, if the Board retains that approach, an additional criterion that the counterparty for the debt and interest rate swap be the same party is needed.

We are supportive of the simplified hedge accounting approach as proposed and also believe that a forward starting interest rate swap should be eligible for accounting under that approach.

Question 5:

Do you agree with the difference in criteria for applying the combined instruments approach versus the simplified hedge accounting approach? If not, please explain why.

Response:

We support the FASB moving forward only with the simplified hedge approach.

Question 6:

For applying the combined instruments approach, should additional criteria about management's intent to hold the swap to maturity (unless the borrowing is prepaid) be included? Please explain why.

Response:

As previously stated, we do not support the combined instrument approach. However, if the Board retains that approach, additional criteria about management's intent to hold the swap to maturity should be included (unless the borrowing is prepaid) because we believe that the General Subsections of Topic 815 should apply if it becomes probable that management will not hold the swap to maturity.

Question 7:

Under the combined instruments approach, should there be a requirement that there have been no adverse developments regarding the risk of counterparty default such that the swap is not expected to be effective in economically converting variable-rate borrowing to fixed-rate borrowing? Please explain why or why not.

Response:

If the FASB adopts the combined instruments approach, more transparency will be helpful to better understand the underlying and the risk of counterparty default. Therefore, if the entity elects this approach, we believe the standard should require the entity to assert that it has considered the risk of counterparty default and determined that the swap is expected to be effective.

Question 8:

Do you agree that the primary difference between settlement value (that is, the amount to be paid to or received from the swap counterparty to terminate the swap) and the fair value is that generally the nonperformance risk of the swap counterparties is not considered in the settlement value? If not, Please explain why.

Response:

We agree.

Question 9:

Would disclosure of the swap's settlement value (instead of its fair value) adequately provide users of financial statements with an indication of potential future cash flows if the swap were to be terminated at the reporting date? If not, please explain why.

Response:

We believe that this disclosure would provide users with sufficient information relevant to potential future cash flows. In addition, we note that for most entities that would be eligible for this accounting election, fair value would generally be impacted only by the entity's nonperformance risk.

Question 10:

Are the costs of obtaining and auditing settlement value significantly less than fair value? Please explain why.

Response:

The costs of obtaining and auditing settlement value is significantly less than fair value because a reporting entity can generally obtain a settlement value from the swap counterparty.

Question 11:

Do you agree that the following should be disclosed if the combined instruments approach is applied and no additional disclosures should be required? If not, please explain why.

a) The settlement value of the swap (along with the valuation method and assumptions)
b) The principal amount of the borrowing for which the forecasted interest payments have been swapped to a fixed rate and the remaining principal amount of the borrowing that has not been swapped to a fixed rate
c) The location and amount of the gains and losses reported in the statement of financial performance arising from early termination, if any, of the swap
d) The nature and existence of credit-risk-related contingent features and the circumstances in which the features could be triggered in a swap that is in a loss position at the end of the reporting period.

Response:

We agree with requiring these disclosures.

Question 12:

Do you agree that the current U.S. GAAP disclosures, including those under Topics 815 and 820 should apply for a swap accounted for under the simplified hedge accounting approach and that the settlement value may be substituted for fair value, wherever applicable, if not, please explain why.

Response:

We agree that settlement value may be substituted for fair value when the simplified hedge accounting approach is applied but that there should be disclosures to indicate that settlement value has been substituted. The final standard should be clear that settlement value is a different measurement method and not intended to represent fair value to avoid any confusion or unintended consequences.

Question 13:

Do you agree with providing an entity-wide accounting policy election for applying the combined instruments approach? If that policy election is availed, should this approach be applicable for all qualifying swaps, whether entered into on or after the date of adoption or existing at that date? If not, please explain why.

Response:

We agree that it should be applicable for all qualifying swaps, whether entered into on or after the date of adoption or existing at that date.

Question 14:

Do you agree that the entity-wide accounting policy election to apply the combined instruments approach must be made upon adoption of the amendments in this proposed Update or, for entities that do not have existing eligible swaps, within a few weeks after the entity enters into its first transaction that is eligible for the accounting policy election? If not, please explain why.

Response:

If the combined instruments approach is retained, we agree that the entity-wide policy election to apply this should be made upon adoption of the proposed Update. For entities that do not have existing eligible swaps, we believe that allowing the entity to make the election within a few weeks after the entity enters into its first transaction that it is eligible for the accounting policy election is also reasonable.

Question 15:

Do you agree that the simplified hedge accounting approach could be elected for any qualifying swaps, whether existing at the date of adoption or entered into on or after the adoption date? If not, please explain why.

Response:

We agree that the simplified hedge accounting approach could be elected for any qualifying swaps, whether existing at the date of adoption or entered into on or after the adoption date.

Question 16:

Do you agree that the election to apply the simplified hedge accounting approach to an existing qualifying swap must be made upon adoption of the amendments in this proposed Update? If not, please explain why.

Response:

We believe that private companies should make the election upon adoption of the proposed amendment to apply the simplified hedge accounting approach to an existing qualifying swap upon adoption of the proposed Update.

Question 17:

Do you agree that the formal documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed within a few weeks of hedge designation under the simplified hedge accounting approach? If not, please explain why.

Response:

We agree that entities should be allowed to complete the formal hedge documentation within a few weeks of hedge designation under the simplified hedge accounting approach.

Question 18:

Do you agree that entities within the scope of this proposed Update should be provided with an option to apply the amendments in this proposed Update using either (a) a modified retrospective approach in which the opening balances of the current period presented would be adjusted to reflect application of the proposed amendments or (b) a full retrospective approach in which financial statements for each individual prior period presented and the opening balances of the earliest period presented would be adjusted to reflect the period-specific effects of applying the proposed amendments? If not, please explain why.

Response:

We agree with the proposal.

Question 19:

Do you agree that an entity within the scope of the proposed Update should be permitted to early adopt the proposed amendments? If not, please explain why.

Response:

Early adoption should be permitted.

Question 20:

How much time is needed to implement the proposed amendments? Please explain.

Response:

We believe that there would be minimal effort needed to implement the proposed amendments.

Question 21:

The scope of this proposed Update uses the term **publicly traded company** from an existing definition in the Master Glossary. In a separate project about the definition of a nonpublic entity, the Board is deliberating which types of business entities would be considered public and would not be included within the scope of the Private Company Decision-Making Framework. The Board and PCC expect that the final definition of a **public business entity** resulting from that project would be added to the Master Glossary and would amend the scope of this proposed Update. The Board has tentatively decided that a public business entity would be defined as a business entity meeting any one of the following criteria:

a. It is required to file or furnish financial statements with the Securities and Exchange Commission.
b. It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities or for purposes of issuing securities.
c. It has issued (or is a conduit bond obligor) for unrestricted securities that can be traded on an exchange or an over-the-counter market.
d. Its securities are unrestricted, and it is required to provide U.S. GAAP financial statements to be made publicly available on a periodic basis pursuant to a legal or regulatory requirement.

Do you agree with the Board's tentative decisions reached about the definition of a public business entity? If not, please explain why.

Response:

We will be providing our more detailed comments in response to your recent proposed ASU. Some of the issues we plan to address in that letter include:

- The FASB should elaborate on whether entities that file or furnish financial statements voluntarily or subject to the requirements of a debt agreement be explicitly included.
- Voluntary filers as well as broker-dealers that are not issuers should also be allowed to elect this accounting alternative.
- More guidance is needed on how to deal with potential implementation issues such as when a nonpublic subsidiary of a public company applies the guidance.