Huron
CONSULTING GROUP

ISSUE-E23

LETTER OF COMMENT NO. 4

September 19, 2007

Mr. Russell G. Golden
Director of Technical Application & Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference: Proposed Issue E23

Dear Mr. Golden:

Thank you for the opportunity to comment on the tentative conclusions in Statement 133 Implementation Issue E23, "Hedging – General: Issues Involving the Application of the Shortcut Method under Paragraph 68" ("DIG Issue E23"). Huron Consulting Group has significant experience in advising clients on complex accounting issues and restatement matters, including identifying the causes for the misapplication of GAAP. We commend the Board for taking up this issue given the application of the shortcut method has caused so many restatements. However, we do not believe the guidance in proposed DIG Issue E23 will accomplish the Board's objective of clarifying the application of the shortcut method and, in fact, may have the opposite effect. As such, we suspect most companies will elect to avoid applying the shortcut method to avoid the risk of restating because of a different interpretation of the guidance in proposed DIG Issue E23.

Specifically, we have concerns about the proposed amendment of paragraph 68(e), including:

- Whether accountants will be able to agree on which terms are "typical" in the marketplace.
- The potential that the proposed guidance is internally inconsistent with respect to its treatment of financing elements embedded within an interest rate swap.

Further, the prohibition against applying the shortcut method when the hedge is entered into after the hedged item is recognized seems arbitrary to us. Given the application of the shortcut method to hedging relationships established subsequent to the issuance of interest-bearing liabilities or the purchase of interest-earning assets seems to have been consistent in practice, we believe the Board is attempting to fix an issue that doesn't exist.

We are concerned that accountants will not be able to agree on which terms of interest rate swaps and interest-bearing financial instruments are typical in the marketplace. We are also concerned with the accounting for existing interest rate swaps for subsequent changes in what terms are considered "typical." It is not clear to us how to management of a company or its auditors are supposed to analyze what is typical in the context of the interest rate swap market given swaps are privately negotiated, customized agreements between two parties to exchange cash flows at specified intervals (payment dates) during the agreed-upon life of the contract (maturity or tenor). While a company will have a basis to compare the terms of an interest rate swap to others it has entered into, it will not know if the terms in those arrangements are typical of the terms included in interest rate swaps entered into by other companies. Finally, the interest rate swap market has evolved over time and will likely continue to evolve, raising questions about the impact of subsequent changes in what terms the market considers "typical" on existing swaps. Additionally, it is not clear on what terms management and auditors should be focused. Presumably not all terms of interest-bearing financial instruments and interest rate swaps need to be evaluated. In the absence of further guidance on this point, we suspect management will be required to spend a significant amount of time attempting to analyze every term (and documenting that analysis) in an attempt to avoid the potential for second-guessing by auditors and regulators. Accordingly, we request the Board to provide further guidance and examples of what terms are considered "typical," and guidance on what implications subsequent changes in "typical" terms has to existing shortcut hedge relationships for those who need to interpret and apply the accounting literature.

As noted above, we are concerned that proposed DIG Issue E23 may include guidance that is internally inconsistent. In particular, the Board, in an example in the Basis for Conclusions, notes that interest rate swaps with changes in notional amounts triggered by unscheduled prepayments could meet the criteria of paragraph 68(a) provided the notional amount of the swap and the outstanding principal amount of the interest-bearing financial instrument are the same amount on each interest payment date. In order to achieve this result, the interest rate swap would have to embed call and put options allowing the company to increase or decrease the notional amount of the swap to equal changes in the outstanding principal amount of the hedged item. In order to meet the criterion in paragraph 68(b), the premium charged by the counterparty for such optionality would have to be financed by adjusting the floating leg of the swap. However, it was not clear to us whether such a structure would cause the arrangement to fail the criterion in paragraph 68(e)(2). Accordingly, we believe the Board should provide guidance on the impact of financing an option premium by adjusting the floating leg of the swap. Without such guidance, we believe accountants will be faced with a conundrum of how to treat the cost of prepayment options for purposes of qualifying for shortcut in light of the guidance in paragraph 68(e), which would seem to imply that these swaps would not qualify for shortcut treatment because the financing of the prepayment option premium would invalidate the assumption of no ineffectiveness.

While we understand that a hedge of an interest-bearing financial instrument subsequent to the origination of that financial instrument could result in more ineffectiveness because of changes in the fair value of the hedged item between when it was originated and when it was hedged, we still do not understand why the Board has decided after all this time to prohibit companies from applying the shortcut method for those arrangements when, to our understanding, there has not been significant diversity in practice, nor do we understand the Board's rationale for its decision. What **term** of the interest-bearing financial instrument or the interest rate swap either invalidates the assumption of no ineffectiveness or is not typical of those instruments at the time the company enters into the hedge? We believe the Board is creating an arbitrary distinction where it's possible for a hedge that does not qualify for shortcut even though it's more effective than a hedge does qualify for shortcut treatment. Finally, we do not see how the guidance in DIG Issue E15 supports the tentative guidance in DIG Issue E23. DIG Issue E15 prohibits the use of the shortcut method subsequent to a business combination because the fair value of the swap would rarely be zero on the acquisition date. DIG Issue E15 says nothing about the terms of the outstanding debt in reaching its conclusions. In light of our concerns, we strongly support the alternative views expressed by the dissenting Board members.

As a final note, if the Board believes the shortcut method no longer serves its intended purpose, we would recommend that, rather than issuing the guidance on proposed DIG Issue E23, the Board accelerates work on the project it added to its agenda in May 2007. One of the objectives of that project is to simplify the accounting for hedging activities; at this point in time, we believe that is an objective shared universally. In contrast to the stated objective of that project, we believe the guidance on proposed DIG Issue E23 will only further complicate the accounting for hedging activities.

We would appreciate the opportunity to participate with the due process on this issue. If the Board or the Staff would like to discuss any of our concerns or our experience with restatements, please call Ken Evola at 202-585-6860, or Jeff Ellis at 312-880-3019.

Sincerely,

/s/ Kenneth J. Evola

Kenneth J. Evola
Managing Director

/s/ Jeffrey H. Ellis

Jeffrey H. Ellis
Managing Director