



August 23, 2013

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Re: File reference no. PCC-13-03

Dear Ms. Cosper:

Grant Thornton LLP appreciates the opportunity to comment on the proposed Accounting Standards Update, *Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – a proposal of the Private Company Council*.

We believe that many private entities struggle with applying the existing hedge accounting guidance due to its complexity and stringent requirements, and we are therefore supportive of making it easier for them to apply hedge accounting for certain less complex arrangements, including those where the interest rate risk of variable rate debt is hedged with a receive-variable, pay-fixed interest rate swap. However, we do not support the proposed guidance in its current form because it would actually add to the complexity of hedge accounting guidance by introducing two new methods to achieve hedge accounting. Rather than adding new methods, we believe that many of the application issues faced by private companies in applying hedge accounting to the arrangements in question can be addressed by making targeted accommodations within existing hedge accounting guidance.

For example, the guidance in *FASB Accounting Standards Codification*[®] (ASC) 815, *Derivatives and Hedging*, specifies a “short cut” method for applying hedge accounting to arrangements in which the hedging instrument is an interest rate swap. The short cut method permits entities to assume zero hedge ineffectiveness and to forgo subsequent assessments of hedge effectiveness provided that certain criteria are met – two of the major benefits of the proposed guidance. One of these criteria is that the hedged item cannot be prepayable, which frequently precludes application of the short cut method to arrangements where the interest rate risk of a variable rate note is hedged with a receive-variable, pay-fixed interest rate swap because many variable rate debt instruments are prepayable. By replacing the requirement that the hedged item not be prepayable with a requirement that an entity affirm at inception that it does not intend to prepay its hedged variable rate debt (or, that in the event the debt is repaid before maturity, the entity will issue new variable rate debt with the same key characteristics to maintain a principal

balance equal to or greater than the notional amount of the swap), we believe that many of these arrangements would qualify for the short cut method of hedge accounting.

Furthermore, we believe that certain other criteria for the short cut method, such as requiring that the repricing dates of the hedged item and hedging instrument exactly match, could be relaxed for private entities as contemplated under the proposed simplified hedge accounting approach.

We believe that if the approach to modify the short cut method is pursued, the Board should consider whether it would be appropriate to allow all entities to apply the modified guidance.

To address another barrier to adopting hedge accounting, we believe that the existing hedge documentation requirements could be relaxed for private entities to allow additional time from the hedge designation date to prepare formal hedge documentation. In this regard, we support the PCC's proposal that private entities be allowed "a few weeks" to prepare hedge documentation.

As explained in our response to Questions 6 and 7, below, we are not supportive of the proposed combined instruments approach, and we believe that if the Board proceeds with the proposed guidance, it should consider adding only the simplified hedge accounting approach to ASC 815. If the Board decides to permit the combined instruments approach, we suggest that its scope be limited to arrangements where the lender is also the swap counterparty.

Following are our responses to the questions in the proposed ASU.

Question 1: Please describe the entity or individual responding to this proposed Update.

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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?

We agree that the scope of the proposed should exclude financial institutions due to the potential for unintended regulatory consequences, but we do not agree with the rationale expressed in paragraph BC 10 of the proposed ASU that because financial institutions often have adequate resources to comply with US GAAP, these entities should be excluded from the scope of the proposed guidance. We believe that there is a wide range of resource levels across large and small private financial institutions, and that there could be a significant number of financial institutions that lack adequate resources to apply hedge accounting under existing guidance. Nevertheless, we do not believe a significant number of financial institutions enter into the types of arrangements addressed within proposed guidance, and we do not object to their exclusion from its scope.

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.

We do not believe the scope of either the combined instruments approach or the simplified hedge accounting approach, as proposed, should be expanded to include publicly traded companies. We do, however, believe that not-for-profit entities should be eligible to apply either of the proposed approaches. If the Board were to make targeted amendments to existing guidance, such as the criteria for applying the short cut method as we suggest elsewhere in this letter, we believe the Board should consider permitting all entities to apply the amended guidance.

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.

As noted elsewhere in this letter, we do not agree with the combined instruments approach on a conceptual basis, and prefer that the objective of the simplified hedge accounting approach be satisfied by making targeted accommodations within the existing hedge accounting guidance, for example, building on the existing criteria for the short cut method.

Nevertheless, if the Board proceeds with the simplified hedge accounting approach, we believe that certain clarifications are necessary to ensure that the proposed criteria function properly.

First, we believe the proposed guidance should make clear whether an entity must determine that the notional amount of the swap is less than or equal to the notional amount of the hedged item not only at inception but for the duration of the hedge. In our view, an entity applying the proposed guidance should assert that the notional amount of the swap will remain less than or equal to the notional amount of the debt as long as the hedge is in place.

Second, we believe the proposed guidance should clarify whether the duration of the indexed variable rate must be the same for the derivative and the hedged item. For example, would the

combination of a swap where the variable leg is based on 1-month LIBOR and debt with a variable rate based on 3-month LIBOR qualify for the simplified hedge accounting approach?

Question 5: Do you agree with the differences in criteria for applying the combined instruments approach versus the simplified hedge accounting approach? If not, please explain why.

We do not agree with permitting the combined instruments approach. However, if the Board decides to permit this approach, we encourage the Board to consider limiting its scope to arrangements where the lender and swap counterparty are the same.

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.

We do not believe that the proposed guidance should include the combined instruments approach because it is inconsistent with other areas of U.S. GAAP, and the same relief to preparers can be provided through the simplified hedge accounting approach or by amending the current short cut method guidance. In addition, we are concerned about the loss of transparency to financial statement users that would occur by not recognizing the interest rate swap as an asset or liability.

ASC 815 requires freestanding derivatives to be recognized as a separate unit of account on the balance sheet and to be measured at fair value. Since the interest rate swaps that fall within the scope of the proposed guidance are freestanding financial instruments, the conceptual basis for not recognizing them on the balance sheet under the combined instruments approach is unclear. We do not believe an exception to the guidance on recognition of freestanding financial instruments is warranted because similar relief to preparers can be provided through the simplified hedge accounting approach or by making other amendments to existing guidance.

We believe that permitting entities to forgo recognition of the interest rate swap on the face of the balance sheet will harm transparency, despite disclosure of an entity's accounting policy choice in the notes. In particular, we are concerned that an entity might have a significant liability under a swap arrangement that is not readily apparent to financial statement users.

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.

Although we disagree with the combined instruments approach, if the Board decides to include it in the final guidance, we believe that the scope of the combined instruments approach should be limited to arrangements where the lender is also the swap counterparty.

We believe there is a fundamental difference between arrangements where the lender and swap counterparty are the same and arrangements where they are different. For example, when the lender and the swap counterparty are the same, the risk of default to the entity when it is in an asset position on the swap is mitigated by its ability to withhold payments on the debt in lieu of cash settlement on the swap. An arrangement where the swap counterparty is not the lender, on the other hand, is subject to future changes in default risk that cannot be mitigated by lending relationship. Also, we believe that the ability to refinance a variable rate debt instrument, and the terms of the refinancing, could depend on whether the lender is also a party to a swap contract with the entity.

Further, we note that in arrangements where the swap counterparty and the lender are the same, an entity could be viewed as substantively net settling its obligation under the debt agreement and its asset or liability associated with the swap contract via periodic simultaneous cash settlements. There is precedent in U.S. GAAP for presenting certain assets and liabilities on a net basis when there is a right of offset. Although the criteria for net presentation would likely not be met for many of the arrangements in question, we believe that arrangements with the same swap counterparty and lender are closer to meeting those criteria than arrangements where the lender and swap counterparty are different.

Accordingly, it is our view that arrangements where the lender is not also the swap counterparty are sufficiently different from fixed rate debt arrangements that they should not be afforded similar accounting.

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 fair value is that generally the nonperformance risk of the swap counterparties is not considered in the settlement value? If not, please explain why.

We agree that the primary difference between the settlement value and fair value of a swap is typically due to the nonperformance risk of the swap counterparties. However, since various swap counterparties compute the settlement value in different ways, there may be situations where a significant difference between settlement value and fair value results from factors other than nonperformance risk.

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.

In general, we believe that disclosure of the swap's settlement value would provide similar information as disclosure of the swap's fair value. Because the fair value of a swap for private entities that might apply the proposed alternative is generally impacted only by the entity's nonperformance risk, we believe financial statement users are less interested in fair value changes. However, we note that despite its label, the settlement value as reported by the swap counterparty is actually not intended to indicate the amount the swap could be settled at. If the

swap were to be settled with the counterparty at the reporting date, we believe that generally the actual settlement amount would exceed the amount reported by the counterparty for financial reporting purposes. We believe that the disclosures should make users aware that the settlement value is not the amount at which the contract could be settled as of the reporting date.

Question 10: Are the costs of obtaining and auditing settlement value significantly less than fair value? Please explain why.

We believe that the costs of obtaining the settlement value are significantly less than the costs of obtaining fair value. However, we do not believe there is a significant difference between the cost of auditing the settlement value versus auditing fair value. Although the settlement value is generally easy to obtain from the swap counterparty, an auditor must apply appropriate procedures to verify its measurement, similar to third party fair value measurements.

Question 11: Do you agree that the following should be disclosed if the combined instruments approach is applied and that 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.

Although we are not supportive of the combined instruments approach, if the Board chooses to proceed with it we agree with the proposed disclosure requirements.

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.

We agree that the current disclosures required under ASC 815 should apply to swaps accounted for under the simplified hedge accounting approach. However, we believe the disclosure requirements in ASC 820, particularly those around “leveling,” might be difficult to apply by simply substituting settlement value for fair value. Also, we believe the Board should consider whether disclosure requirements similar to those for entities that present NAV as a practical expedient for fair value are warranted.

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.

Although we are not supportive of the combined instruments approach, if the Board chooses to proceed with it we agree with applying an entity-wide accounting policy election, and we believe that it should be applicable to all qualifying swaps.

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.

Although we are not supportive of the combined instruments approach, if the Board chooses to proceed with it we agree that the entity-wide accounting policy election must be made upon adoption of the proposed guidance or within a few weeks of the entity entering into its first eligible arrangement.

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.

We agree that the simplified hedge accounting approach could be elected for any qualifying swaps.

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.

We agree that this election must be made upon adoption of the proposed guidance.

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.

We agree with allowing private companies a few weeks from the designation date to prepare formal hedge documentation.

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.

We agree with the proposed transition options.

Question 19: Do you agree that an entity within the scope of this proposed Update should be permitted to early adopt the proposed amendments? If not, please explain why.

We agree that early adoption should be permitted.

Question 20: How much time is needed to implement the proposed amendments? Please explain.

We do not believe a significant amount of time would be needed to implement the proposed guidance.

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.

We believe this question should be addressed in response to the proposed Accounting Standards Update, *Definition of a Public Business Entity: An Amendment to the Master Glossary*.

We would be pleased to discuss our comments with you. If you have any questions, please contact Mark Scoles, Partner – Accounting Principles Consulting Group, at 312.602.8780 or Mark.Scoles@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP