



August 23, 2013

Ms. Susan Cospers
Technical Director
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Financial Accounting Standards Board
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PricewaterhouseCoopers 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* (the “proposed standard”).

The proposed standard, in tandem with two other proposed Accounting Standards Updates, demonstrates the Private Company Council’s (the PCC) and the FASB’s (the Board) continuing efforts to address the specific financial reporting needs of preparers and users of private company financial statements. We support these efforts and encourage the PCC and the Board to continue to identify areas where either proposed or existing accounting standards may be modified to better support the needs of preparers and users of private company financial statements.

As discussed in our comment letter dated June 13, 2013 on the Board’s Invitation to Comment on the Private Company Decision-Making Framework (the Framework), we believe that in most cases the financial reporting that is relevant to users of public company financial statements is also relevant to users of private company financial statements. In addition, modifications to the recognition and measurement guidance for private companies should be rare and limited to instances where users of private company financial statements have clearly different information needs than users of public company financial statements.

From the basis for conclusions in the proposed standard, it is not clear how the needs of private company financial statement users differ from the needs of public company users to support significant changes to the existing hedge accounting model under ASC 815. While we support portions of the proposed standard, we do not believe a sufficient basis exists to justify limiting certain of the proposed changes to only private companies.

Under the current hedge accounting model, it can be challenging and costly for preparers to design, perform, and document quantitative tests of hedge effectiveness. Those efforts seem overly burdensome and unnecessary when the terms of the debt instrument and the interest rate swap are so close that it appears obvious that there is no material amount of ineffectiveness



present in the hedging relationship. Although relief from extensive effectiveness testing seems warranted in the circumstances, we do not believe that it should result in the Board departing from its core principle that all of an entity's financial instruments should be recognized in the financial statements.

In developing the current hedge accounting guidance in ASC 815, the Board eliminated synthetic instrument accounting, because that accounting would be inconsistent with the Board's fundamental objective of increasing the transparency of derivative activities by requiring entities to report all derivative instruments in the financial statements. The proposed combined instruments approach reintroduces the concept of synthetic accounting that is prohibited by ASC 815. Further, with the exception of the swap's periodic settlements, this approach ignores the specific separate unit of account that the interest rate swap represents in the transaction. For these reasons, we are not supportive of this approach.

While the combined instruments approach may seem like a significant simplification, we believe it is of marginal benefit given that the settlement value of the interest rate swap must still be determined and disclosed. The only advantage as compared with the proposed simplified hedge accounting approach is through the elimination of the balance sheet entry to recognize the derivative instrument and the related balance in other comprehensive income, which we believe is insufficient to justify the reintroduction of synthetic instrument accounting.

The second alternative, the proposed simplified hedge accounting approach, eliminates the burden of preparing and documenting effectiveness testing, while maintaining the Board's core principle that all of an entity's financial instruments should be recognized in the financial statements. This approach is not significantly different from the critical terms match method that is applied in practice today. Accordingly, we not only support this alternative, we recommend the Board make it available to all entities, not just private companies.

We are sympathetic to the burdens of determining fair value for interest rate swaps, and for practical reasons would be supportive of providing some relief to private companies. However, the settlement value described in the proposed standard does not appear to be a viable approach. It is our understanding that determining a true settlement value (i.e., that is the determination of the amount to be paid or received upon early settlement or the unwinding of a derivative instrument) involves more complexity than simply removing the non-performance risk of the swap counterparties from the present value of the predicted future settlements, as suggested in the proposed standard. We understand that counterparties will likely require compensation for other related risks, such as the cost of unwinding its own hedge position and the related out-of-pocket costs to analyze and transact the offsetting positions. For these reasons, we believe that the settlement value described in the proposed standard does not represent the price at which the instrument would be unwound, nor do we believe that this amount could be readily obtained



or verified by reference to other sources. We propose instead that “settlement value” be replaced with the discounted present value of the remaining estimated cash flows under the agreement using mid-market pricing for creditworthy counterparties. This amount would likely be more effective at arriving at the goals of the standard than would the current proposal. Furthermore, we believe that this amount should be readily determinable by private companies or easily obtainable from outside sources.

We question whether a shortened comment period will be sufficient for constituents to fully assess the implications of the significant changes being proposed, including whether the proposed standard should be available for all entities. However, we recognize that the PCC and, in turn, the Board may decide to move forward with the proposed standard for private companies only. If that is the case, we have provided in Appendix A our responses to certain of the questions included in the proposed standard.

Finally, given the difference that the proposed standard would create in the application of hedge accounting between private and public companies, it may be inappropriate in many cases for a private company that applies the proposed standard and subsequently becomes a public company to apply hedge accounting in its historical financial statements prepared under the public company reporting model. As such, we believe transition guidance or an accommodation should be provided for those situations. Otherwise, those private companies would effectively be precluded from complying with U.S. GAAP as public companies, unless they reversed the effects of the hedge accounting allowed under the proposed standard.

In conclusion, we believe that the economics of transactions and arrangements should be reflected in the financial statements regardless of how the enterprise has chosen to access capital. We are not convinced that there are clear differentiators between the needs of users of public company and private company financial statements with respect to the use of derivatives in cash flow hedging relationships where the hedged item is an entity’s own debt obligation. We therefore encourage the FASB to explore changes to the model for both public and private companies. We advocate the simplification of accounting standards for all preparers where the revised standards reasonably reflect the economics of a transaction.

If you have any questions regarding our comments, please contact Patrick Durbin at (973) 236-5152, John Althoff at (973) 236-7021, or Kirsten Schofield at (973) 236-4054.

Sincerely,

PricewaterhouseCoopers LLP



Appendix A

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.

As more fully described in our cover letter, we do not support the combined instruments approach for use by any companies, public or private, financial institutions or non-financial institutions.

The simplified hedge accounting approach is not significantly different from the critical terms match method that is applied in practice today. Accordingly, we support the Board formalizing the simplified hedge accounting approach, and recommend it be made available to all entities, not just private companies.

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.

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.

Please refer to our cover letter.

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.

The proposed accounting under the combined instruments approach when an interest rate swap is terminated early appears to provide for immediate recognition in earnings of the swap settlement value even in situations where the hedged debt instrument continues to exist. However, for early swap terminations involving similar hedging relationships not designated under the combined instruments approach, such amounts will be recognized in other comprehensive income and reclassified to earnings in future periods as the hedged forecasted interest payments impact earnings. We believe that the early termination of an interest rate swap under the combined instruments approach should be treated similarly to all other hedging relationships with the swap settlement value deferred in other comprehensive income. Adopting such a requirement would prevent an entity from managing its income through the early termination of the off-balance sheet interest rate swap and eliminate the need for the additional criteria to 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.

Yes. We believe that it is fundamental to hedge accounting that a hedge strategy can only be effective if the derivative counterparty is expected to perform. If there is a subsequent adverse development in the risk of counterparty default, the basis for applying hedge accounting has been undermined and the continuation of hedge accounting may no longer be justified.

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.

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.

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

Please refer to our cover letter.

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)

As stated in our cover letter, we do not support the combined instruments approach because it reintroduces synthetic hedge accounting and provides only marginal benefit, as compared with the simplified hedge accounting approach. Additionally, we do not support the proposed use of settlement value, and instead, we recommend it be replaced with the discounted present value of the remaining estimated cash flows under the agreement using mid-market pricing for creditworthy counterparties.

Although disclosing the settlement value arguably undermines one of the potential advantages of treating the debt instrument and interest rate swap on a combined basis, we support the



disclosure requirement, because the interest rate swap is a separate financial instrument from the debt instrument. We believe users should be made aware of the value of an entity's off-balance sheet derivative positions, along with the valuation method and key 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

Yes. It is important information for the users of financial statements to know the principal amounts of fixed rate (albeit synthetically) and floating rate debt, as well as the notional amount of the interest rate swap and its key contractual features.

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

Yes. We believe these amounts could often be important in gauging the quality of earnings.

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.

Yes. Just as counterparty credit issues are fundamental to all hedge relationships, understanding contingent credit aspects of derivatives is a necessary part of informing the users of financial statements of potential claims on liquidity and capital of the reporting entity.

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.

The proposed standard states that the settlement value of an interest rate swap designated as a hedge under the simplified approach "may be used in place of fair value" when making the disclosures required by the new guidance or under other fair value disclosure requirements, such as those in Topic 820. If a private company makes this election, we recommend that the Board require this disclosure to clearly indicate that the amounts are a settlement value and not fair value. Only amounts determined in accordance with the guidance in Topic 820 should be presented as fair value.



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.

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.

As previously stated, we do not support the combined instruments approach. However, if it is adopted, we question the effectiveness of a requirement that it be applied only on an entity-wide basis. Because hedge accounting is elective, it would seem that an entity with a policy for applying the combined instruments approach could still avoid applying that approach by deciding not to apply hedge accounting. Alternatively, the entity could delay the contracting of their swap by more than a few days and would thus not qualify for the combined instruments approach. In that case, that entity would be free to apply the simplified approach or another hedge accounting method under ASC 815.

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.

Yes. We believe that the simplified approach could be applied to existing positions upon adoption of the proposed standard and to new swap positions upon, or approximate to, their trade date subsequent to adoption.

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 applying the simplified approach to an existing swap should generally only be permitted upon initial adoption of the proposed standard. However, we do not believe that an existing qualifying swap should be precluded from subsequently being designated under the simplified approach if it later meets the criteria. It may be unlikely that an aged interest rate swap would have a fair value somewhat near zero and meet all of the other qualifying criteria for designation, but it is possible.



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.

No. We do not believe that the extension of the deadline for completing the formal hedge documentation is necessary. There are no requirements to perform any initial tests of effectiveness for entities to elect hedge accounting under either of the proposed approaches. The proposed standard provides objective criteria required to qualify under either approach. An entity must simply assert that they are electing hedge accounting under the combined instruments approach per ASC 815-50-15-2 or the simplified approach per ASC 815-20-25-131D. We do not foresee the need for significant time to document this election.

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.

Yes. We believe either method is acceptable. However, given the difference that the proposed standard would create in the application of hedge accounting between private and public companies, it may be inappropriate in many cases for a private company that applies the proposed standard and subsequently becomes a public company to apply hedge accounting in its historical financial statements prepared under the public company reporting model. As such, we believe transition guidance or an accommodation should be provided for those situations. Otherwise, those private companies would effectively be precluded from complying with U.S. GAAP as public companies, unless they reversed the effects of the hedge accounting allowed under the proposed standard.

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.

Because the application of hedge accounting is elective, we believe the proposed changes should be effective immediately upon issuance of the final standard and early adoption should be permitted.



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

We do not believe that there will be any significant systems or implementation issues associated with the proposed hedge accounting changes. Therefore, we do not believe significant time will be 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.

Subsequent to the issuance of this exposure draft, the FASB issued a proposed ASU on the definition of a Public Business Entity. PwC plans to separately comment on that exposure draft.