

American Institute of CPAs 220 Leigh Farm Road Durham, NC 27707-8110

August 28, 2013

Susan M. Cosper, CPA Technical Director FASB 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Re: July 1, 2013 Exposure Draft of a Proposed Accounting Standards Update (ASU), Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps [File Reference No. PCC-13-03]

Dear Ms. Cosper:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC is comprised of 13 practitioners from CPA firms of varying sizes ranging from less than 10 professionals to more than 1,000 professionals. All member firms focus on audits of nonpublic entities; some firms also audit public companies or public employee benefit plans.

TIC has reviewed the ED and is providing the following comments for your consideration.

## GENERAL COMMENTS

TIC is supportive of the combined instruments approach and the simplified hedge accounting approach. TIC believes the alternatives proposed will encourage more entities to take advantage of hedge accounting since it will now be less costly and less complex to apply. However, TIC believes the Board should consider reductions in the amount of disclosure requested of preparers. These points are discussed further below.

## **SPECIFIC COMMENTS**

**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.)

Yes, TIC agrees that financial institutions should be excluded from the combined instruments approach and the simplified hedge accounting approach. TIC's view is based on a presumption that financial institutions have the in-house expertise to apply the requirements of current GAAP. In addition, TIC presumes that they would invest in swaps of a more complex nature that would not qualify for the accounting alternatives in this ED.

**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.

TIC has decided not to comment on expanding the scope of the accounting alternative to publicly traded companies. However, if the Board decides to do so, it should be structured as a separate project and should not delay the issuance of this ED for private companies.

TIC supports expanding the scope of the accounting alternative to not-for-profit organizations (NFPs), since these entities have encountered the same issues as private companies. TIC did not discuss whether any changes should be considered for these approaches when applied to NFPs.

**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.

Yes, TIC believes the criteria are straightforward and easy to apply.

**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.

Generally, yes. The combined approach looks at the swap and the borrowing as one instrument, so TIC believes the terms of the two instruments should be approximately the same. The criteria for the simplified hedging approach differ from those of the combined approach in two respects: 1) the term of the swap can be less than the term of the borrowing; and 2) the swap does not have to be effective at the same time as the borrowing. TIC believes these differences in criteria warrant the application of a different 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.

No. TIC believes any additional criteria would add an unneeded layer of complexity. Preparers are already required to disclose settlement value (the amount due if the swap is terminated early). In TIC's experience, very few swaps that would meet the criteria for these accounting alternatives are terminated early or separately from the related debt.

**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.

No, TIC believes such a requirement is unnecessary and would add too much subjectivity.

This analysis would be inherent in any audit or review engagement when giving consideration to any potential contingencies (ASC Topic 450, Contingencies). If you had reason to believe there was a performance issue, TIC believes you would already have a responsibility to address it as part of the audit or review. Paragraph 815-50-35-2, which discusses the conditions under which the combined instruments approach could no longer be used, recognizes that the approach may not be permanent.

**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.

Yes. Typically, counterparty credit risk is not a significant issue due to the nature of the entities entering into the swaps (typically major financial institutions or insurance companies).

**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.

Yes, TIC believes this is the relevant point of reference for financial statement users.

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

Yes, settlement value is preferable since it reduces complexity and potentially promotes consistent treatment from an accounting calculation perspective. In most cases, clients can obtain the settlement value directly from the counterparty.

**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.

TIC disagrees with the proposed disclosures for the settlement value of the swap (item [a] above). Disclosures about the valuation method and the assumptions for the settlement value are generally not available from the bank or, at best, this information is very difficult to obtain. More importantly, this additional information is not relevant because the counterparty for the swap and the lender for the borrowing are the same bank, which is generally one of the primary users of the financial statements. As a result, the valuation methods and assumptions used in determining the settlement value provide no additional useful information to the financial statement users.

TIC believes the disclosures in items (b) through (d) above are reasonable.

**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.

TIC believes simplifying the accounting without also scaling back the disclosures seems somewhat counterintuitive given the Board's purpose. TIC believes the disclosures under the combined approach would also be suitable for the simplified hedge accounting approach, especially since settlement value, rather than fair value, will be used in measuring the swap.

**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.

TIC supports an entity-wide accounting policy election for applying the combined instruments approach to all qualifying swaps. However, it is not a common occurrence in practice to see smaller private entities have multiple, qualifying interest rate swaps outstanding concurrently. An entity in that position should not be allowed to elect which qualifying swaps would be accounted for under the combined approach and which would not. Permitting such an election would potentially open up opportunities for manipulating financial results.

If an entity elects to use this accounting alternative, TIC believes it should be applicable for all qualifying interest rate 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.

No, TIC does not support an accounting policy election criterion based on "within a few weeks" of the inception of the hedge, because many private entities only prepare annual financial statements. As a practical matter, management may not fully consider all of the relevant facets of accounting until the auditor arrives to audit or the accountant arrives to review or compile the annual financial statements. TIC therefore recommends that the accounting policy election time frame be expanded to the point in time that the financial statements are available to be issued for the fiscal year that the entity entered into the swap transaction. Furthermore, TIC recommends that this expanded time frame also be applied to the preparation of the hedge documentation.

**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, TIC supports this conclusion.

**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.

No, TIC believes the election could be made later. Please see TIC's response to Question 14.

**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, TIC believes the documentation could be prepared at a later time. Please see TIC's response to Question 14.

**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, TIC agrees that entities should be allowed to elect either modified or full retrospective adoption.

**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.

Yes, TIC agrees that early adoption should be permitted.

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

Accounting firms would need to change work programs/manuals and accounting guidance and train the staff. Educational efforts for clients would be necessary, too, but most would easily understand and adopt the new option.

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:

TIC has decided not to comment on the definition of a public business entity in its response to this proposal. TIC plans to comment separately on the Proposed ASU, *Definition of a Public Business Entity—An Amendment to the Master Glossary*, which was issued on August 7, 2013.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Karen Kerber, Chair

Karen Kerber

**PCPS Technical Issues Committee** 

cc: PCPS Executive and Technical Issues Committees