FASB Exposure Draft

Proposed Accounting Standards Update

Issued: July 1, 2013
Comments Due: August 23, 2013

Derivatives and Hedging (Topic 815)

Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps

a proposal of the Private Company Council

This Exposure Draft of a proposed Accounting Standards Update of Topic 815 is issued by the Board for public comment. Comments can be provided using the electronic feedback form available on the FASB website. Written comments should be addressed to:

Technical Director
File Reference No. PCC-13-03

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by August 23, 2013. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. PCC-13-03
- Sending written comments to "Technical Director, File Reference No. PCC-13-03, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

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FASB

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Private Company Council (PCC) received input through outreach that private companies often find it difficult to obtain fixed-rate borrowing. Therefore, some private companies enter into receive-variable, pay-fixed interest rate swaps ("swap") to economically convert their variable-rate borrowings ("borrowing") to fixed-rate borrowings. Under U.S. generally accepted accounting principles (GAAP), a swap is a derivative instrument. Topic 815, Derivatives and Hedging, requires that an entity recognize all of its derivative instruments on its balance sheet as either assets or liabilities and measure them at fair value. To mitigate the income statement volatility of recording a swap at fair value, Topic 815 permits an entity to elect "cash flow hedge" accounting if certain requirements under that Topic are met. Some private company stakeholders contend that because of limited resources and/or the complexity of understanding and applying hedge accounting, many private companies lack the expertise to comply with the requirements to qualify for cash flow hedge accounting. Therefore, they do not elect to apply hedge accounting, which results in income statement volatility. In addition, some stakeholders question the relevance and cost associated with determining and presenting the fair value of a swap that is entered into for the purposes of economically converting its variable-rate borrowing to fixed-rate borrowing.

The objective of the amendments in this proposed Update is to address the concerns of private company stakeholders by allowing two alternative approaches, which are simpler in comparison to Topic 815, in accounting for certain types of swaps that are entered into by a private company for the purposes of economically converting variable-rate borrowing to fixed-rate borrowing.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities, except publicly traded companies, not-for-profit entities, as defined in the Master Glossary of the *FASB Accounting Standards Codification*®, employee benefit plans within the scope of Topics 960 through 965 on plan accounting, and financial institutions. As described in paragraph 942-320-50-1, the term *financial institutions* includes banks, savings and loan associations, savings banks, credit unions, finance companies, and insurance entities.

What Are the Main Provisions?

The amendments in this proposed Update would provide two simpler approaches, the *combined instruments approach* and the *simplified hedge accounting approach,* to account for swaps that are entered into for the purposes of economically converting variable-rate borrowing to fixed-rate borrowing. Under both approaches, the periodic income statement charge for the interest expense would be similar to the amount that would result if the entity had directly entered into fixed-rate borrowing, instead of variable-rate borrowing and a swap. Alternatively, that entity could continue to follow the current guidance in Topic 815.

The combined instruments approach would provide entities within the scope of this proposed Update with an entity-wide accounting policy election to apply a scope exception from the current guidance in Topic 815 such that the swap and the borrowing are accounted for as one combined financial instrument. In other words, the swap would *not* be recorded in the entity's financial statements (except for the period-end accrual relating to the next swap settlement). This approach can be applied if all of the following criteria are met:

a. Both the variable rate on the swap and the borrowing are based on the same index and interest rate (for example, 1-month London Interbank Offered Rate [LIBOR]).
b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a "plain-vanilla" swap, even though that term is not defined), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.
c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.
d. The swap's fair value at inception (that is, at the time of application of the combined instruments approach) is at or near zero.
e. The swap is not a forward-starting swap.
f. The notional amount of the swap is equal to, or less than, the principal amount of the borrowing.
g. The term of the swap approximates the term of the borrowing.
h. The swap is effective at the same time as the borrowing or within a few days.

If an entity elects to adopt the combined instruments approach, that approach would be applicable to all of its swaps, both existing at the date of adoption or entered into on or after the date of adoption, provided that the requirements of applying this approach otherwise are met. The election should 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. In determining whether an existing swap otherwise would meet all of the requirements for applying the combined instruments approach, the criterion that the swap's fair value at the time of application of this approach is at or near zero does not need to be considered. Instead, as long as the swap's fair value was at or near zero at the time the swap was entered into (or acquired) by the entity, application of the combined instruments approach would be required.

The fair value disclosures of Section 825-10-50, Financial Instruments—Overall—Disclosure, would not apply to swaps accounted for under the combined instruments approach. Furthermore, for the purposes of applying the scope exception in paragraph 825-10-50-3, a swap accounted for under the combined instruments approach would not be considered to be an instrument that is accounted for as a derivative instrument under Topic 815. However, the settlement value of the swap (along with the valuation method and assumptions) would be disclosed. The primary difference between a 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. In addition, 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 would be disclosed under the combined instruments approach. Furthermore, the location and amount of the gains and losses, if any, arising from early termination of the swap, the nature and existence of credit-risk-related contingent features, and the circumstances in which those features could be triggered in a swap that is in a loss position at the end of the reporting period also would be disclosed under that approach.

The simplified hedge accounting approach would provide entities within the scope of this proposed Update with a practical expedient to qualify for hedge accounting under Topic 815. Under this approach, the swap and the related borrowing would continue to be accounted for as two separate financial instruments; however, no ineffectiveness would be assumed for qualifying swaps designated in a hedging relationship under Topic 815. The designated swap may be recorded at settlement value in the entity's financial statements, instead of at fair value. This approach can be applied provided all of the following criteria are met:

a. Both the variable rate on the swap and the borrowing are based on the same index and interest rate (for example, 1-month LIBOR).
b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a "plain-vanilla" swap, even though that term is not defined), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.
c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.
d. The swap's fair value at inception (that is, at the time of application of the simplified hedge accounting approach) is at or near zero.
e. The swap is not a forward-starting swap.

f. The notional amount of the swap is equal to or less than the principal amount of the borrowing.
g. The term of the swap is equal to *or less than* the term of the borrowing.

The criteria to qualify for simplified hedge accounting are similar to the criteria proposed under the combined instruments approach; however, the term of the swap could be less than the term of the borrowing and the swap does not have to be effective at the same time as the borrowing.

The simplified hedge accounting approach would allow for the hedge documentation under paragraph 815-20-25-3 to be completed within "a few weeks" of the hedge designation, instead of requiring that documentation to be completed concurrently at the inception of the hedge. Because Topic 815 permits election of hedge accounting on a *swap-by-swap basis*, an entity within the scope of this proposed Update could elect to apply the simplified hedge accounting approach to any swaps, whether existing at the date of adoption or entered into on or after that date, provided that the requirements of applying this approach otherwise are met. The election to apply the simplified hedge accounting approach to an existing swap should be made upon adoption of the amendments in this proposed Update. In determining whether an existing swap otherwise would meet all of the requirements for applying the simplified hedge accounting approach, the criterion that the swap's fair value at the time of application of this approach is at or near zero does not need to be considered. Instead, as long as the swap's fair value was at or near zero at the time the swap was entered into (or acquired) by the entity, application of the simplified hedge accounting approach would be permitted.

The current disclosures for a swap recognized in the entity's financial statements would continue to apply under the simplified hedge accounting approach. Those include the disclosures required by Topic 815 and the disclosures applicable to an entity within the scope of this proposed Update under Topic 820, Fair Value Measurement. In providing those disclosures, the settlement value of the swap may be substituted for fair value wherever applicable.

How Would the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Would They Improve U.S. GAAP for Private Company Stakeholders?

The proposed Private Company Decision-Making Framework augments the existing conceptual framework for financial reporting by providing additional considerations in making user-relevance and cost-benefit evaluations for private companies.

The amendments in this proposed Update would provide entities within the scope of this proposed Update with the benefit of two approaches that simplify the accounting for certain types of swaps that are entered into for the purpose of economically converting variable-rate borrowings to fixed-rate borrowings, thus mitigating private company stakeholders' concerns about the costs, complexity, and relevance of applying current U.S. GAAP to swaps in those circumstances. Because the periodic income statement charge for the interest expense under the combined instruments approach and the simplified hedge accounting approach would be similar to the amount that would result if the entity had directly entered into fixed-rate borrowing instead of variable-rate borrowing and a swap, the amendments in this proposed Update would reduce income statement volatility and address private company stakeholders' concerns in that regard while still providing relevant information.

The amendments in this proposed Update would allow the swap to be measured at its settlement value instead of fair value when applying the simplified hedge accounting approach. In addition, only the settlement value instead of fair value is required to be disclosed under the combined instruments approach. Because the settlement value generally is provided by the swap counterparty, the PCC believes that it would alleviate the cost and complexity concerns that have been raised by some private company stakeholders with regard to estimating fair value. For financial statement users who find relevance in swaps that will no longer be recognized upon application of the combined instruments approach, the PCC notes that disclosing the settlement value of those swaps under the combined instruments approach would continue to provide those users with information similar to fair value to facilitate a more detailed discussion with management, if warranted.

Overall, the PCC believes that the two approaches that simplify the accounting for certain types of swaps are responsive to the unique needs of private company stakeholders. The PCC believes that the alternative approaches would continue to provide decision-useful information to the users of private company financial statements, while providing a reduction in the cost and complexity in accounting for such swaps by preparers. Therefore, the PCC believes that the proposed amendments meet the overall objective of the proposed Private Company Decision-Making Framework for addressing the unique needs of private company stakeholders.

When Would the Amendments Be Effective?

The effective date will be determined after considering stakeholder feedback on the proposed Update. Entities within the scope of this proposed Update would be provided with an option to apply the amendments in this proposed Update using either (1) 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 (2) 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. Early adoption would be permitted.

Questions for Respondents

The Board and the PCC invite individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

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

a. Please indicate whether you primarily are a preparer, user, public accountant, or other (if other, please specify).
b. If you are a preparer of financial statements, please indicate whether your entity is privately held or publicly held and describe your primary business and its size (in terms of annual revenue, the number of employees, or other relevant metric).
c. If you are a public accountant, please describe the size of your firm (in terms of number of partners or other relevant metric) and indicate whether your practice focuses primarily on public entities, private entities, or both.
d. If you are a user of financial statements, please indicate in what capacity (for example, lender, investor, analyst, or rating agency) and whether you primarily use financial statements of private entities or those of both private entities and public entities.

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.)

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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.

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

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.

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–9. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following Master Glossary terms to Subtopic 815-20 as follows:

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Publicly Traded Company

A business entity that has any of the following characteristics:

a. Whose securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally)
b. That is a conduit bond obligor for **conduit debt securities** that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets)

c. Whose financial statements are filed with a regulatory agency in preparation for the sale of any class of securities in a domestic market.

Amendments to Subtopic 815-10

3. Amend paragraphs 815-10-05-1 through 05-2, with a link to transition paragraph 815-10-65-6, as follows:

Derivatives and Hedging—Overall

Overview and Background

General

815-10-05-1 The Derivatives and Hedging Topic includes the following Subtopics:

a. Overall
b. Embedded Derivatives
c. Hedging—General
d. Fair Value Hedges
e Cash Flow Hedges
f. Net Investment Hedges
g. Contracts in Entity's Own Equity
h. Weather Derivatives.
i. Combined Instruments Approach.

815-10-05-2 The first six Subtopics address the accounting for **derivative instruments**, including certain derivative instruments embedded in other contracts, and hedging activities. The last ~~two~~ three Subtopics provide guidance on accounting for contracts that have characteristics of derivative instruments but that are not accounted for as derivative instruments under this Subtopic.

4. Add paragraphs 815-10-35-1A through 35-1B, with a link to transition paragraph 815-10-65-6, as follows:

Subsequent Measurement

815-10-35-1 All derivative instruments shall be measured subsequently at **fair value**.

815-10-35-1A As a practical expedient, a receive-variable, pay-fixed interest rate swap (swap) for which the simplified hedge accounting approach (see paragraphs 815-20-25-131A through 25-131D) is applied may be measured using the settlement value of that swap, instead of fair value**.**

815-10-35-1B If any of the conditions in paragraph 815-20-25-131D for applying the simplified hedge accounting approach subsequently cease to be met or the relationship otherwise ceases to qualify for hedge accounting, the General Subsections of this Topic shall apply at the date of change and on a prospective basis. For example, if the swap is terminated early without the related variable-rate borrowing being prepaid, the gain or loss on the swap in accumulated other comprehensive income shall be accounted for as discussed in paragraphs 815-30-35-38 through 35-41. Similarly, if the related variable-rate borrowing is prepaid without terminating the swap, the swap shall be measured subsequently at fair value with the changes in fair value accounted for in accordance with the guidance in paragraphs 815-10-35-2 through 35-3 on a prospective basis.

5. Add paragraph 815-10-50-3, with a link to transition paragraph 815-10-65-6, as follows:

Disclosure

815-10-50-3 ~~Paragraph not used.~~ If the simplified hedge accounting approach (see paragraphs 815-20-25-131A through 25-131D) is applied in accounting for a qualifying receive-variable, pay-fixed interest rate swap, the settlement value of that swap may be used in place of **{add glossary link to 2nd definition} fair value {add glossary link to 2nd definition}** when disclosing the information required by this Section or in providing other fair value disclosures, such as those required under Topic 820 on fair value.

Amendments to Subtopic 815-20

6. Amend paragraph 815-20-25-119 and add paragraphs 815-20-25-131A through 25-131D and their related heading, with a link to transition paragraph 815-10-65-6, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> > Hedge Effectiveness Criteria Applicable to Cash Flow Hedges Only

815-20-25-119 The hedge effectiveness criteria applicable to cash flow hedges only are organized as follows:

a. Consideration of the time value of money
b. Consideration of counterparty credit risk
c. Additional considerations for options in cash flow hedges
d. Assuming no hedge ineffectiveness in a cash flow hedge with an interest rate swap (simplified hedge accounting approach).

> > > Assuming No Hedge Ineffectiveness in a Cash Flow Hedge with an Interest Rate Swap (Simplified Hedge Accounting Approach)

815-20-25-131A The conditions for the simplified hedge accounting approach do not determine which cash flow hedging relationships qualify for hedge accounting; rather, those conditions determine which cash flow hedging relationships qualify for a simplified version of hedge accounting that does not immediately recognize hedge ineffectiveness. If all of the conditions in paragraph 815-20-25-131D are met, no ineffectiveness may be assumed in a cash flow hedging relationship involving a variable-rate borrowing and a receive-variable, pay-fixed interest rate swap (swap).

815-20-25-131B Provided all of the conditions in paragraph 815-20-25-131D are met, the simplified hedge accounting approach may be applied by any entity, except **{add glossary link to 2nd definition} publicly traded companies {add glossary link to 2nd definition}, not-for-profit entities**, employee benefit plans within the scope of Topics 960 through 965 on plan accounting, and financial institutions as described in paragraph 942-320-50-1. An entity may elect the simplified hedge accounting approach for any swap, provided that all of the conditions of applying the simplified hedge accounting approach specified in paragraph 815-20-25-131D are met.

815-20-25-131C As a practical expedient in applying the simplified hedge accounting approach, the formal documentation required by paragraph 815-20-25-3 to qualify for hedge accounting may be completed within a few weeks of the hedge designation, instead of concurrently at hedge inception.

815-20-25-131D An entity must meet all of the following conditions to apply the simplified hedge accounting approach to a cash flow hedging relationship:

a. Both the variable rate on the swap and the borrowing are based on the same index and interest rate (for example, 1-month London Interbank Offered Rate [LIBOR]).
b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a “plain-vanilla” swap, even though that term is not defined), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.
c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.
d. The swap’s fair value at inception (that is, at the time of application of the simplified hedge accounting approach) is at or near zero.
e. The swap is not a forward-starting swap.
f. The notional amount of the swap is equal to or less than the principal amount of the borrowing.
g. The term of the swap is equal to or less than the term of the borrowing.

Addition of Subtopic 815-50

7. Add Subtopic 815-50, with a link to transition paragraph 815-10-65-6, as follows: **[Note: For ease of readability, the new Subtopic is not underlined.]**

Derivatives and Hedging—Combined Instruments Approach

Overview and Background

General

815-50-05-1 This Subtopic provides guidance on accounting for certain receive-variable, pay-fixed interest rate swaps.

Scope and Scope Exceptions

General

> Entities

815-50-15-1 The guidance in this Subtopic applies to all entities, except **{add glossary link to 2nd definition} publicly traded companies {add glossary link to 2nd definition}**, **not-for-profit entities**, employee benefit plans within the scope of Topics 960 through 965 on plan accounting, and financial institutions as described in paragraph 942-320-50-1.

> Instruments

815-50-15-2 The guidance in this Subtopic applies to a receive-variable, pay-fixed interest rate swap (swap) that meets all of the following conditions:

a. Both the variable rate on the swap and the borrowing are based on the same index and interest rate (for example, 1-month London Interbank Offered Rate [LIBOR]).
b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a "plain-vanilla" swap, even though that term is not defined), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.
c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.
d. The swap's **{add glossary link to 2nd definition} fair value {add glossary link to 2nd definition}** at inception (that is, at the time of application of the combined instruments approach) is at or near zero.
e. The swap is not a forward-starting swap.
f. The notional amount of the swap is equal to or less than the principal amount of the borrowing.
g. The term of the swap approximates the term of the borrowing.
h. The swap is effective at the same time as the borrowing or within a few days.

Glossary

Fair Value

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
b. Operating purposes other than to provide goods or services at a profit
c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

a. All investor-owned entities
b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Publicly Traded Company

A business entity that has any of the following characteristics:

a. Whose securities are traded in a public market on a domestic stock exchange or in the domestic over-the-counter market (including securities quoted only locally or regionally)
b. That is a conduit bond obligor for **conduit debt securities** that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets)
c. Whose financial statements are filed with a regulatory agency in preparation for the sale of any class of securities in a domestic market.

Recognition

General

815-50-25-1 An entity within the scope of this Subtopic shall not separately recognize in its statement of financial position a receive-variable, pay-fixed interest rate swap (swap) for which the combined instruments approach is applied. Under that approach, an accrual for the most imminent net cash settlement on the swap is recognized in the statement of financial position and not the swap itself. The related variable-rate borrowing that has been swapped shall continue to follow applicable recognition guidance in other Topics.

815-50-25-2 Application of the combined instruments approach is an accounting policy election that shall apply to all swaps, provided that all of the conditions of applying the combined instruments approach specified in paragraph 815-50-15-2 are met.

Subsequent Measurement

General

815-50-35-1 An entity within the scope of this Subtopic shall recognize in its statement of financial position an accrual for the most imminent net cash settlement on a receive-variable, pay-fixed interest rate swap (swap) for which the combined instruments approach is applied, if that amount is known (generally, that amount is known because interest rate resets on a swap are typically prospective, not retrospective). The related variable-rate borrowing that has been swapped shall continue to follow applicable measurement guidance in other Topics.

815-50-35-2 If any of the conditions in paragraph 815-50-15-2 for applying the combined instruments approach subsequently cease to be met, the General Subsections of Topic 815 shall apply at the date of change and on a prospective basis. For example, if the swap is terminated early, the gain or loss on early termination of the swap shall be recognized in earnings in accordance with the guidance in paragraphs 815-10-35-2 through 35-3. Similarly, if the related variable-rate borrowing is prepaid without terminating the swap, the swap shall subsequently be recognized in the statement of financial position of the entity and measured at **{add glossary link to 2nd definition} fair value {add glossary link to 2nd definition}** on a prospective basis with the changes in fair value accounted for in accordance with the guidance in paragraphs 815-10-35-2 through 35-3.

Disclosure

General

815-50-50-1 The following information shall be disclosed for every annual and interim reporting period for which a statement of financial position and a statement of financial performance are presented:

a. The settlement value (see paragraph 815-10-35-1A) of a receive-variable, pay-fixed interest rate swap (swap) for which the combined instruments approach is applied
b. The method(s) and significant assumptions used to estimate the settlement value of the swap and a description of the changes during the period, if any, in the method(s) and significant assumptions used to estimate that settlement value
c. The principal amount of variable-rate borrowing for which the forecasted interest payments have been swapped to a fixed rate and the remaining

principal amount of the variable-rate borrowing not swapped to a fixed rate

d. 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
e. The existence and nature 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.

Those disclosures are in addition to any disclosures required by other Subtopics, including Subtopic 470-10 on debt, for the related variable-rate borrowing.

Amendments to Subtopic 825-10

8. Amend paragraphs 825-10-50-3 and 825-10-50-8, with a link to transition paragraph 815-10-65-6, as follows:

Financial Instruments—Overall

Disclosure

825-10-50-3 Except as noted in the following paragraph, for annual reporting periods, the disclosure guidance related to fair value of financial instruments in paragraphs 825-10-50-10 through 50-19 applies to all entities but is optional for an entity that meets all of the following criteria:

a. The entity is a **nonpublic entity**.
b. The entity's total assets are less than $100 million on the date of the financial statements.
c. The entity has no instrument that, in whole or in part, is accounted for as a derivative instrument under Topic 815 <u>on derivatives and hedging</u> other than commitments related to the origination of mortgage loans to be held for sale during the reporting period. <u>For purposes of this guidance, a receive-variable, pay-fixed interest rate swap for which the combined instruments approach (see Subtopic 815-50) is applied shall not be considered an instrument that is accounted for as a derivative instrument under Topic 815.</u>

825-10-50-3A A nonpublic entity is not required to provide the disclosure in paragraph 825-10-50-10(d) for items disclosed at fair value but not measured at fair value in the statement of financial position.

> > Transactions

825-10-50-8 In part, this Subsection requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, except that the disclosures about fair value prescribed in paragraphs 825-10-50-10 through 50-16 are not required for any of the following:

a. Employers' and plans' obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements (see Topics 710; 712; 715; 718; and 960)
b. Substantively extinguished debt subject to the disclosure requirements of Subtopic 405-20
c. Insurance contracts, other than financial guarantees (including financial guarantee insurance contracts within the scope of Topic 944) and investment contracts, as discussed in Subtopic 944-20
d. Lease contracts as defined in Topic 840 (a contingent obligation arising out of a cancelled lease and a guarantee of a third-party lease obligation are not lease contracts and are subject to the disclosure requirements in this Subsection)
e. Warranty obligations (see Topic 450 and the Product Warranties Subsections of Topic 460)
f. Unconditional purchase obligations as defined in paragraph 440-10-50-2
g. Investments accounted for under the equity method in accordance with the requirements of Topic 323
h. Noncontrolling interests and equity investments in consolidated subsidiaries (see Topic 810)
i. Equity instruments issued by the entity and classified in stockholders' equity in the statement of financial position (see Topic 505).
j. Receive-variable, pay-fixed interest rate swaps for which the combined instruments approach is applied (see Topic 815).

9. Add paragraph 815-10-65-6 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2013-XX, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps*

815-10-65-6 The following represents the transition and effective date information related to Accounting Standards Update No. 2013-XX, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps:*

a. The pending content that links to this paragraph shall be effective for fiscal years beginning after [date to be inserted after exposure], and interim and annual periods thereafter.
b. The pending content that links to this paragraph related to the combined instruments approach shall be applied in either of the following ways:
    1. Using a modified retrospective approach in which the **{add glossary link to 2nd definition} fair value {add glossary link to 2nd definition}** recorded in the statement of financial position for swaps existing at the effective date would be reversed by making

an offsetting adjustment to the opening balance of retained earnings (or other appropriate components of equity) of the current period presented.

2. Using a full retrospective approach in which:
   i. The financial statements for each individual prior period presented would be adjusted to reflect the period-specific effects of applying the combined instruments approach.
   ii. The fair value recorded in the statement of financial position for swaps existing at the beginning of the earliest period presented would be reversed by making an offsetting adjustment to the opening balance of retained earnings (or other appropriate components of equity) of that earliest period presented.

c. Application of the combined instruments approach is a policy election that shall apply to all qualifying swaps, both existing at the date of adoption or entered into after that date. The election shall be made upon adoption of the pending content that links to this paragraph 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. In determining whether an existing swap meets all of the conditions in paragraph 815-50-15-2 to qualify for applying the combined instruments approach, the condition that the swap's **{add glossary link to 2nd definition} fair value {add glossary link to 2nd definition}** at the time of application of this approach is at or near zero need not be considered. Instead, as long as the swap's fair value was at or near zero at the time the swap was entered into (or acquired) by the entity, application of the combined instruments approach shall be required.

d. The pending content that links to this paragraph related to the simplified hedge accounting approach shall be applied in either of the following ways:
   1. Using a modified retrospective approach in which offsetting adjustments would be made to the opening balance of accumulated other comprehensive income and retained earnings (or other appropriate components of equity) of the current period presented to reflect application of hedge accounting under this Topic from the date the swap was entered into (or acquired) by the entity.
   2. Using a full retrospective approach in which:
      i. The financial statements for each individual prior period presented would be adjusted to reflect the period-specific effects of applying hedge accounting under this Topic from the date the swap was entered into (or acquired) by the entity.
      ii. Offsetting adjustments would be made to the opening balance of accumulated other comprehensive income and retained earnings (or other appropriate components of equity) of the earliest period presented to reflect application of hedge

accounting under this Topic from the date the swap was entered into (or acquired) by the entity.

e. The simplified hedge accounting approach may be elected for any qualifying swap, whether existing at the date of adoption or entered into after that date. The election to apply the simplified hedge accounting approach to an existing swap shall be made upon adoption of the pending content that links to this paragraph. In determining whether an existing swap meets all of the conditions in paragraph 815-20-25-131D to qualify for applying the simplified hedge accounting approach, the condition that the swap's fair value at the time of application of this approach is at or near zero need not be considered. Instead, as long as the swap's fair value was at or near zero at the time the swap was entered into (or acquired) by the entity, the entity may apply the simplified hedge accounting approach. For an existing swap, the formal documentation required by paragraph 815-20-25-3 to qualify for hedge accounting may be completed within a few weeks of adoption of the pending content that links to this paragraph, instead of concurrently at hedge inception.

f. Early application of the pending content that links to this paragraph is permitted.

g. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period that the entity adopts the pending content that links to this paragraph.

The amendments in this proposed Update were endorsed and approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Leslie F. Seidman, *Chairman*
Daryl E. Buck
Russell G. Golden
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the PCC's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for endorsing the PCC's conclusions when needed to supplement the PCC's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual PCC members and Board members gave greater weight to some factors than to others.

Background Information

BC2. The PCC received input through outreach that private companies often enter into swaps to economically convert their variable-rate borrowing to fixed-rate borrowing. Under U.S. GAAP, an interest rate swap is a derivative instrument. In a receive-variable, pay-fixed interest rate swap, an entity will receive a variable rate and pay the swap counterparty a fixed rate (the swap rate) on the notional amount of the swap. The variable rate paid on the borrowing is offset by the variable rate received from the swap counterparty; however, the company still has to pay the agreed fixed rate on the swap (and any credit spread on the borrowing). In effect, the interest rate swap fixes the interest rate associated with the borrowing and mitigates the exposure to the risk of changes in cash flows due to changes in interest rates.

BC3. Topic 815, Derivatives and Hedging, requires that an entity recognize all of its derivative instruments on its balance sheet as either assets or liabilities and measure them at fair value. However, to mitigate the income statement volatility of recording a swap at fair value, Topic 815 permits an entity to elect "cash flow hedge" accounting if certain requirements are met. Those include formal designation and concurrent documentation at hedge inception and periodic assessments of hedge effectiveness. For a perfectly matching swap and borrowing, application of cash flow hedge accounting results in presenting interest expense in the income statement as if the entity had issued a fixed-rate borrowing.

BC4. Some private company stakeholders contend that because of limited resources and/or the complexity of understanding and applying hedge accounting, many private companies lack the expertise to comply with the requirements to qualify for cash flow hedge accounting or the resources to prepare the documentation concurrently. Therefore, many private companies do not elect to apply hedge accounting, which results in income statement volatility due to changes in the fair value of the swap being recognized in current earnings without an accounting offset to reflect that the private company has economically converted its variable-rate borrowing into a fixed-rate borrowing by entering into that swap.

BC5. The PCC evaluated the derivatives and hedging accounting guidance in Topic 815 for receive-variable, pay-fixed interest rate swaps under the recognition and measurement module of the proposed Private Company Decision-Making Framework, which has been exposed for public comment, to determine whether current U.S. GAAP requirements provide relevant information to users of private company financial statements at a reasonable cost. The PCC observed that the proposed Private Company Decision-Making Framework places more weight on the considerations that address user relevance.

BC6. Since the issuance of the derivatives and hedging accounting guidance, many preparers and primary users (especially lenders) of private company financial statements have voiced concerns regarding the accounting for interest rate swaps and the related volatility in the income statement in the absence of applying hedge accounting. The PCC considered feedback from private company stakeholders through various channels, including (a) direct outreach to private company stakeholders, (b) nonpublic entity roundtables conducted by the Board, (c) written submissions to the Blue-Ribbon Panel on Standard Setting for Private Companies and the Financial Accounting Foundation’s Plan to Establish a Private Company Standards Improvement Council, and (d) the Private Company Financial Reporting Committee. Considering the difficulties faced by private companies in electing hedge accounting, those stakeholders believe that a simplified alternative accounting approach should be provided for private companies that enter into swaps for the purposes of economically converting their variable-rate borrowing to fixed-rate borrowing.

BC7. In addition, many preparers and users of private company financial statements questioned the relevance of and cost associated with determining and presenting the fair value of a swap that is entered into for the purposes of economically converting the variable-rate borrowing to fixed-rate borrowing, particularly when the swap counterparty is the same as the lender. They noted that in those circumstances, it is the primary user of the financial statements (lender) who provides the swap’s value to the entity for reporting purposes and the swap generally is held for the term of the related borrowing. Furthermore, they note that when the swap counterparty is the same as the lender, the combination of the variable-rate borrowing and the swap, in effect, creates a fixed-rate borrowing between that lender and the borrower. Those stakeholders believe that an alternative accounting approach should be provided for private companies in those circumstances. In addition, many users of private company financial statements stated that they reverse the swap’s fair value changes in determining adjusted EBITDA because those changes do not affect the entity’s expected future cash flows. Many users of private company financial statements, including lenders and investors, also indicated that they have direct access to management to obtain additional relevant information. Considering that some private companies may enter into a swap with a counterparty that is different than the lender, the PCC decided to allow application of the alternative accounting approaches described in this proposed Update irrespective of the swap counterparty, provided that the criteria to apply those approaches otherwise are met.

BC8. The PCC observed that the guidance in Topic 815 for receive-variable, pay-fixed interest rate swaps in circumstances in which those swaps are entered into for the purposes of economically converting variable-rate borrowing to fixed-rate borrowing, meet the user relevance and cost and complexity criteria discussed in the proposed Private Company Decision-Making Framework. In other words, the PCC determined that in those circumstances, the derivatives and hedging guidance in Topic 815 can result in an outcome that is not relevant to the primary users of private company financial statements and is costly and too complex to apply.

BC9. The PCC discussed this issue at its February 12, 2013 meeting and determined that there is a sufficient basis to consider alternative accounting for receive-variable, pay-fixed interest rate swaps that are entered into for the purposes of economically converting a variable-rate borrowing to fixed-rate borrowing and decided to add a project to its agenda in that regard. At its May 7, 2013 meeting, the PCC reached a decision to allow two simpler approaches, the "combined instruments approach" and the "simplified hedge accounting approach" in accounting for certain types of interest rate swaps that are intended to economically convert variable-rate borrowing of an entity within the scope of this proposed Update to a fixed-rate borrowing. On June 10, 2013, the Board endorsed the decisions of the PCC, leading to the issuance of the amendments in this proposed Update.

Scope and Other Considerations

BC10. The PCC decided the scope of this proposed Update should be consistent with the scope of the proposed Private Company Decision-Making Framework that has been exposed for public comment by the Board and the PCC. This includes all entities except for publicly traded companies, not-for-profit entities, and employee benefit plans within the scope of Topics 960 through 965. In addition, the PCC reached a decision to exclude financial institutions from the scope of this proposed Update considering that such entities generally use numerous derivative instruments, and, therefore, introducing a special accounting model only for certain types of swaps would be confusing to users. These financial institutions generally also have adequate resources to comply with the current U.S. GAAP requirements in Topic 815. Furthermore, because financial institutions typically are regulated entities, there also could be unintended regulatory consequences in providing these entities with alternative accounting. The Board and the PCC acknowledge that decisions about whether an entity may apply permitted alternatives within U.S. GAAP may ultimately be determined by regulators, lenders, and other creditors or other financial statement users that require U.S. GAAP financial statements.

BC11. To apply the combined instruments approach, which is a scope exception to the current derivatives and hedging guidance and essentially results in the swap being off balance sheet, the PCC decided that strict criteria would have to be met to demonstrate that the swap was entered into by an entity within the scope of this proposed Update for the purposes of economically converting a variable-rate borrowing to fixed-rate borrowing. Those criteria include the swap term approximating the term of the borrowing, and the swap being effective at the same time as the borrowing. Alternatively, if the term of the swap is less than the term of the borrowing or the swap is effective at a later date and not at the same time as the borrowing, the PCC decided to provide an entity within the scope of this proposed Update with a practical expedient, the simplified hedge accounting approach, to qualify for hedge accounting provided all the other criteria are met.

BC12. The PCC deliberated whether swaps other than "plain-vanilla" swaps should be allowed use of the combined instruments approach and/or the simplified hedge accounting approach. The PCC decided to limit those approaches to a narrow set of circumstances that addresses the prevalent practice issue of a private company entering into a plain-vanilla swap for the purposes of economically converting its variable-rate borrowing to fixed-rate borrowing. As such, the PCC observed that use of other than "plain-vanilla" swaps may reflect more sophisticated structured financing arrangements that would not provide the sufficiently narrow set of circumstances to apply the proposed alternative accounting approaches.

BC13. The PCC noted that including an interest rate floor in borrowings provided during periods of low interest rates is not uncommon and does not contradict the objective of economically having a fixed-rate borrowing. Similarly, in a high-interest environment, a cap on interest rates could be included. Therefore, the PCC allowed application of the simplified approaches if a floor or a cap feature is included in the swap but only if there is a comparable provision in the borrowing. The PCC noted that for this purpose, comparable does not necessarily mean equal. For example, if the swap's variable rate is LIBOR and the borrowing's variable rate is LIBOR plus 2 percent, a 10 percent cap on the swap would be comparable to a 12 percent cap on the borrowing.

BC14. The PCC decided to obtain stakeholder feedback through the comment letter process on whether an additional criterion about management's explicit intent at swap inception to hold that swap to maturity (unless the borrowing is prepaid) should be included for determining eligibility to apply the combined instruments approach, in other words, whether early terminations of a swap without a corresponding prepayment of the borrowing should be very infrequent because that may be contrary to the entity's objective of economically obtaining fixed-rate borrowing. Early terminations of the swap that result from events that could not have been reasonably anticipated, such as an unexpected and urgent need for capital to avoid filing for bankruptcy, generally would be considered as being very infrequent. Management of the entity could consider pertinent historical experience, such as historical early terminations of the swap and the reasons for them, in assessing whether the objective of entering into the swap for the purposes of economically obtaining a fixed-rate borrowing is met.

BC15. Because the effectiveness of the swap in economically converting variable-rate borrowing to fixed-rate borrowing involves assessing the likelihood of the counterparty's compliance with the contractual terms of the swap, the PCC also decided to obtain stakeholder feedback through the comment letter process on whether, in applying the combined instruments approach, entities within the scope of this proposed Update also must assess whether there have been adverse developments regarding the risk of counterparty default. The PCC notes that such an assessment would be carried out under the simplified hedge accounting approach in applying cash flow hedge accounting under Topic 815.

BC16. The PCC noted that the provision of "a few days" in the proposed criteria does not require further elaboration; instead, application of that phrase may be left up to practice to determine in applying the proposed approaches. In carrying out that determination, the PCC observed that "a few days" is not intended to provide a blanket or extended period of exception from the criteria that the repricing and settlement dates for the swap and the borrowing match and, if the combined instruments approach is applied, that the swap be effective at the same time as the borrowing, but is provided only as a means to address administrative or other practicability concerns. The PCC noted that this approach is preferable to specifying any bright-line threshold, for example, a difference of no more than a week.

BC17. Similarly, the PCC noted that the provision of "a few weeks" from the contemporaneous documentation requirements does not require further elaboration; instead, application of that phrase may be left up to practice to determine in applying the simplified hedge accounting approach. The PCC observed that "a few weeks" is not intended to provide a blanket or extended period of exception from the contemporaneous hedge documentation requirements of Topic 815, but is provided only as a means to address administrative or other practicability concerns. The PCC noted that this approach is preferable to specifying any bright-line threshold, for example, a delay of no more than two weeks.

BC18. The PCC observed that the notional amount of the swap could be less than the principal amount of the borrowing. Therefore, to provide transparency about how much of the variable-rate borrowing has been economically converted to fixed-rate borrowing, the PCC decided the principal amount of the borrowing for which the forecasted interest payments have been swapped to a fixed rate and the remaining principal amount that has not been swapped to a fixed rate should be disclosed if the combined instruments approach is applied. Because the swap is essentially off balance sheet under the combined instruments approach, the PCC decided that this disclosure is especially important under that approach because otherwise information about the amount swapped will not be obtained from either the presentation or other disclosures.

BC19. Some private company stakeholders, particularly the more sophisticated users, assert that disclosing the key terms of each swap, such as term, notional amount, and the swap fixed rate, would provide more relevant and predictive information than a point-in-time measurement, such as settlement value or fair value. However, the PCC observed that disclosing the key terms of a swap may not be relevant for less sophisticated users and may clutter the footnotes of entities within the scope of this proposed Update that have numerous lending arrangements and/or numerous swaps. If not provided individually for each swap, providing the key terms on an aggregate basis (for example, as a range) may not provide predictive value at the desired swap level. Furthermore, if information about the key terms of the swap is desired, typical private company users, such as lenders, other creditors, and equity investors, generally have direct access to management and can ask for, and usually obtain, additional details related to the content of financial statements. The PCC also noted that disclosing key terms of the swap is not required for public entities and it does not believe that incremental disclosures should be provided for entities within the scope of this proposed Update.

BC20. The PCC observed that certain swaps may contain credit-risk-related contingent provisions. For example, if the private company were to fail to maintain its status as a well-capitalized entity as may be mutually defined, the counterparty to the swap could request immediate payment or demand immediate and ongoing full overnight collateralization on swaps in net liability positions. The PCC noted that Topic 815 requires disclosure of credit-risk-related contingent features that would apply under the simplified hedge accounting approach. Similarly, for private companies that apply the combined instruments approach, the PCC believes that disclosing 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 would provide relevant information.

BC21. Because Topic 825 requires disclosures about fair value for all financial instruments, whether recognized or not recognized in the statement of financial position, the PCC noted that questions may arise as to whether those fair value disclosures should apply to the swaps accounted for under the combined instruments approach. The PCC decided that the fair value disclosures prescribed in paragraphs 825-10-50-10 through 50-16 would not apply to swaps accounted for under the combined instruments approach. Furthermore, the PCC clarified that for the purposes of applying the scope exception in paragraph 825-10-50-3, a swap accounted for under the combined instruments approach would not be considered to be an instrument that is accounted for as a derivative instrument under Topic 815.

BC22. The PCC noted that Section 235-10-50, Notes to Financial Statements—Overall—Disclosure, requires that a description of all significant accounting policies, including principles and methods peculiar to the industry in which the entity operates, shall be included as an integral part of the financial statements. The PCC believes that accounting policy disclosure also would address the policy and measurement bases of receive-variable, pay-fixed interest rate swaps, if considered significant.

Transition and Early Adoption

BC23. The PCC reached a decision that entities within the scope of this proposed Update would 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. The PCC noted that the option for a full retrospective transition would provide entities within the scope of this proposed Update with the ability to present consistent accounting for similar transactions occurring in prior periods presented, thereby facilitating comparability within the entity's financial statements.

BC24. The PCC decided to allow application of the combined instruments approach and/or the simplified hedge accounting approach to existing swaps that meet the qualifying criteria. The election to apply those approaches to an existing swap should be made upon adoption of the amendments in this proposed Update. To address administrative or other practicability concerns, the PCC decided that for entities that do not have existing eligible swaps, the election to apply the combined instruments approach could be made within a few weeks after the entity enters into its first transaction that is eligible for the accounting policy election.

BC25. As a one-time transition amendment, the PCC noted that the condition that the swap's fair value at the time of application of the combined instruments approach and/or the simplified hedge accounting approach is at or near zero need not be considered. Instead, as long as the swap's fair value was at or near zero at the time the swap was entered into (or acquired) by the entity, application of the combined instruments approach and/or the simplified hedge accounting approach to existing swaps would be required or permitted, as applicable. Similarly, in applying the simplified hedge accounting approach to existing swaps, the formal documentation required by paragraph 815-20-25-3 to qualify for hedge accounting may be completed within a few weeks of the effective date of the proposed amendments, instead of concurrently at hedge inception. The PCC noted that allowing application of the combined instruments approach and/or the simplified hedge accounting approach to existing swaps would address concerns regarding the accounting for those swaps and the related volatility in the income statement in the absence of applying hedge accounting.

BC26. The PCC decided to permit early application of the proposed amendments to benefit entities within the scope of this proposed Update as soon as is practicable.

Effect on User-Relevance and Cost under the Private Company Decision Framework

BC27. The objective of financial reporting is to provide information that is useful to present and potential users in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The proposed Private Company Decision-Making Framework augments the existing conceptual framework for financial reporting by providing additional considerations in making user-relevance and cost-benefit evaluations for private companies. The proposed Private Company Decision-Making Framework is a tool to help the Board and the PCC identify differential information needs between users of public company financial statements and users of private company financial statements and to identify opportunities to reduce the complexity and costs of preparing financial statements in accordance with U.S. GAAP. The PCC's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC28. The proposed amendments would provide entities within the scope of this proposed Update with the benefit of two approaches that simplify the accounting for certain types of swaps that are entered into for the purpose of economically converting variable-rate borrowing to fixed-rate borrowing, thus mitigating private company stakeholders' concerns about the costs, complexity, and relevance of applying current U.S. GAAP to swaps in those circumstances. Because the periodic income statement charge for the interest expense under the combined instruments approach and the simplified hedge accounting approach would be similar to the amount that would result if the entity had directly entered into fixed-rate borrowing instead of a variable-rate borrowing and a swap, the amendments in this proposed Update would reduce income statement volatility and address private company stakeholders' concerns in that regard while still providing relevant information.

BC29. The amendments in this proposed Update would allow the swap to be measured at its settlement value instead of fair value when applying the simplified hedge accounting approach. In addition, only the settlement value instead of fair value is required to be disclosed under the combined instruments approach. The PCC decided to obtain stakeholder feedback through the comment letter process but preliminarily understands that the primary difference between a 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. Because the settlement value generally is provided by the swap counterparty, the PCC believes that it would alleviate the cost and complexity concerns that have been raised by some private company stakeholders with regard to estimating fair value. For financial statement users who find relevance in swaps that will no longer be recognized upon application of the combined instruments approach, the PCC notes that disclosing the settlement value of those swaps under the combined instruments approach would continue to provide those users with information similar to fair value to facilitate a more detailed discussion with management, if warranted.

BC30. Overall, the PCC believes that the two approaches that simplify the accounting for certain types of swaps are responsive to the unique needs of private company stakeholders. The PCC believes that the alternative approaches would continue to provide decision-useful information to the users of private company financial statements, while providing a reduction in the cost and complexity in accounting for certain swaps. Therefore, the PCC believes that the proposed amendments meet the overall objective of the proposed Private Company Decision-Making Framework for addressing the unique needs of private company stakeholders.