



Deloitte & Touche LLP  
Ten Westport Road  
P.O. Box 820  
Wilton, CT 06897-0820

August 23, 2013

Tel: +1 203 761 3000  
Fax: +1 203 834 2200  
www.deloitte.com

Ms. Susan M. Cospers  
Technical Director  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, CT 06856-5116

**File Reference No. PCC-13-03**

**Re: Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps***

Dear Ms. Cospers:

We appreciate the opportunity to comment on the FASB's proposed Accounting Standards Update (ASU) *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps*.

We support the efforts of the Private Company Council (PCC) and the FASB to address the accounting and financial reporting needs of nonpublic entities and the users of their financial reports. We believe that any amendments to the Codification as a result of such efforts should be consistent with and completed only after the principles in the FASB's and PCC's proposed private-company decision-making framework are finalized.<sup>1</sup> As to this proposal, we have significant objections about certain aspects of the proposed ASU.

We do not support the combined instruments approach because we believe it is not consistent with the fundamental cornerstones of derivative accounting stated in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In addition, an interest rate swap that has not been recorded on the statement of financial position reduces transparency and may mask certain risks that arise from the swap (e.g., the credit risk of the swap counterparty). We do not believe that the needs of nonpublic entities warrant such a dramatic departure from the conceptual foundation of the existing derivative and hedge accounting models. If the Board disagrees with us and ultimately decides to permit entities to use the combined instruments approach, it should significantly narrow its application with additional criteria which we note in the appendix to this letter (see our response to Question 4).

---

<sup>1</sup> Because one of the accounting alternatives in this proposed ASU could significantly change the recognition and measurement of interest rate swaps, we want to reiterate the beliefs we previously expressed in our comment letter on the FASB's Invitation to Comment *Private Company Decision-Making Framework*, including the following:

1. There should be a rebuttable presumption that accounting standards for public and nonpublic companies should be the same except when differences are justified.
2. There should be a higher threshold for differences pertaining to recognition and measurement (i.e., compared with presentation, disclosure, effective dates, etc.).
3. Amendments to the Codification generally should not deviate from the conceptual framework.

Page 2  
August 23, 2013  
File Reference No. PCC-13-03

The simplified hedge accounting approach, with certain modifications, may be an acceptable interim practical alternative for nonpublic entities to use while the Board reconsiders its existing hedge accounting model as part of the ongoing financial instruments project. One appeal of this approach is that it accommodates nonpublic entities while adhering to the framework of the existing hedging accounting model, and does not create an entirely new accounting model; that is, unlike the combined instruments approach, the simplified hedge accounting approach makes minor adjustments to the measurement guidance of the existing shortcut model. Furthermore, although we believe that fair value is the most relevant measurement attribute for derivatives, we would not object to nonpublic entities' use of the settlement value of the interest rate swap as a basis for both measurement and disclosure as long as such use is limited to circumstances in which the credit risk of the swap counterparty is insignificant.

We recommend that the proposal's transition be limited to prospective application (1) to reduce complexity and (2) because we do not believe it is appropriate for entities to apply hedge accounting with the benefit of hindsight. Such limitation appears to be consistent with the Board's historical practice for other amendments to the hedging requirements.

Lastly, the proposed private-company decision-making framework points out that nonpublic entities have "fewer and less specialized accounting personnel" than public companies. The framework indicates that one of the implications of fewer resources is the potential need to increase the amount of response time for private companies (e.g., for commenting on exposure drafts). However, the comment periods for the first three PCC proposals are some of the shortest of any FASB proposal; we therefore recommend that future proposals have longer comment periods.

The appendix below contains our detailed responses to the questions for respondents in the proposed ASU.

\*\*\*\*

Deloitte & Touche LLP appreciates your consideration of our comments on the proposed ASU. If you have any questions regarding our responses, please contact either Mark Bolton (203-761-3171) or Adrian Mills (203-761-3208).

Yours truly,  
Deloitte & Touche LLP

cc: Robert Uhl

**Appendix**  
**Deloitte & Touche LLP**  
**Responses to the Proposed ASU's Questions for Respondents**

*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.)*

We agree that financial institutions of the type described in ASC 942-320-50-1 should be excluded from the scope of any final ASU. Financial institutions should have sufficient resources and expertise to fully apply ASC 815 and ASC 820 and could experience unintended regulatory consequences if they applied the provisions of the proposed ASU (as acknowledged in BC10).

We do recommend, however, that the final ASU clarify whether a nonpublic parent entity of a financial institution that is not itself a financial institution would be permitted to apply the proposed alternatives in its consolidated financial statements even if all or some of the related hedging activities occur at the financial institution subsidiary level.

*Question 3: Should the Board consider expanding the scope of either the combined instruments approach or the simplified hedge accounting approach (or both) to other entities, such as publicly traded companies or not-for-profit entities? If the scope is expanded to other entities, what changes, if any, should the Board consider for these approaches? Please explain why.*

We do not believe that the Board should expand the scope of the combined instruments approach to other entities. As noted in our cover letter, we do not support the use of the combined instruments approach. If that approach is retained, however, we believe its scope should be strictly limited (see our response to Question 4).

We believe the simplified hedge accounting approach would most likely be useful for not-for-profit entities and, therefore, support outreach to determine whether that approach should be extended to such entities.

*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.*

**Combined Instruments Approach**

We oppose the use of the combined instruments approach for the same reasons the Board cited in paragraph 350 of Statement 133:

Page 4  
August 23, 2013  
File Reference No. PCC-13-03

The Board decided not to allow synthetic instrument accounting because to do so would be inconsistent with (a) the fundamental decision to report all derivatives in the financial statements, (b) the fundamental decision to measure all derivatives at fair value, (c) the Board's objective to increase the transparency of derivatives and derivative activities, and (d) the Board's objective of providing consistent accounting for all derivative instruments and for all hedging strategies. Synthetic instrument accounting also is not conceptually defensible because it results in netting assets against liabilities (or vice versa) for no reason other than an asserted "connection" between the netted items.

In addition, giving nonpublic entities two more methods of hedge accounting on top of the methods permitted under current guidance (e.g., long-haul and shortcut methods) could add complexity for users.

However, if the Board ultimately decides to allow nonpublic entities to use the combined instruments approach, it should require them to first satisfy the following additional qualifying criteria (on top of those in ASC 815-50-15-2):

- The lender and the swap counterparty must be part of the same consolidated entity.
- Both parties must enter into the interest rate swap and the variable-rate borrowing contemporaneously and in contemplation of one another.
- Management must intend to hold the swap throughout the life of the debt (see response to Question 6).
- At inception, and on an ongoing basis, the nonpublic entity must have an expectation that the swap will be effective in economically converting variable-rate borrowing to a fixed-rate borrowing (see response to Question 7).

Such criteria would provide a stronger economic justification for accounting for the two instruments as a single combined instrument. Furthermore, to avoid diversity in practice, criterion ASC 815-50-15-2 (g) should clarify how many days the term of the swap can differ from the term of the borrowing before it no longer "approximates" the term of the borrowing.

### **Simplified Hedge Accounting Approach**

We generally agree with the proposed qualifying criteria for the simplified hedge accounting approach. However, the final ASU should emphasize that to initially (and subsequently) qualify for the approach, a nonpublic entity would have to satisfy the requirements in ASC 815-20-25-122 and ASC 815-20-35-14.

*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.*

For the reasons discussed above, we do not support permitting a combined instruments 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.*

Page 5  
August 23, 2013  
File Reference No. PCC-13-03

We do not support the combined instruments approach and believe that if the Board retains that approach in the final ASU, it should further limit its application. Because the combined instruments approach treats the variable rate borrowing and the interest rate swap as a single instrument, we believe that management should be required to have the intent to hold the swap until the maturity of the borrowing. If the Board adds this requirement, it should also address in the final ASU the notion of “tainting” (i.e., the Board should address whether management’s decision to subsequently terminate a swap accounted for under the combined instruments approach before the maturity (or prepayment) of the borrowing would call into question management’s intent to hold other swaps accounted for under the combined instruments approach and whether management would have to discontinue the use of the combined instruments approach for all qualifying swaps for a specified period of time).

*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.*

If the Board decides to retain the combined instruments approach in the final ASU, we believe that an entity that elects to use it should be required to maintain an expectation throughout the life of the combined instrument relationship that the swap will continue to be effective in economically converting the variable-rate borrowing to a fixed-rate borrowing by monitoring the risk of counterparty default. Otherwise, application of the combined instruments approach may not reflect the true economic substance of the combined transactions and may mask the credit risk associated with the hedging instrument. Instead of adding a new criterion for applying the combined instruments approach, the final ASU could accomplish the same objective by referring to ASC 815-20-25-122 and ASC 815-20-35-14.

*Question 8: Do you agree that the primary difference between settlement value (that is, the amount to be paid to or received from the swap counterparty to terminate the swap) and fair value is that generally the nonperformance risk of the swap counterparties is not considered in the settlement value? If not, please explain why.*

We agree that the primary difference between settlement value and fair value is the exclusion of counterparty credit risk. We recommend, however, that the Board explicitly define “settlement value” in the Master Glossary.

*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.*

We believe that settlement value would give financial statement users an adequate indication of a nonpublic entity’s potential future cash flows when the credit risk of the counterparties is considered insignificant (as supported by a qualitative assessment). Thus, we would not object to the use of settlement value in these instances (as long as the qualitative assessment is required) but believe that

Page 6  
August 23, 2013  
File Reference No. PCC-13-03

entities should still have the option to use fair value. However, we encourage the Board to solicit feedback from the investor community on this issue.

If the Board decides not to require ongoing assessment of the swap counterparties' credit risk as a qualifying criterion, it should require a reporting entity to disclose, at a minimum, any "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" as stated in Question 7 above.

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

We agree that the costs of obtaining and auditing the settlement value would be less than those for obtaining and auditing the fair value of the interest rate swap, though the difference may not always be significant. The primary driver of this difference is the cost and complexity of calculating and testing any credit or debit valuation adjustment when measuring the swap's fair value.

*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.*

We do not support the use of the combined instruments approach.

If the Board decides to retain the combined instruments approach in the final ASU and the final ASU does not require an entity to monitor the swap counterparty's credit risk as a qualifying criterion for the use of the combined instruments approach, in addition to the disclosures above, the final ASU should require a reporting entity to disclose, at a minimum, any "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" (see Question 7).

*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.*

Page 7  
August 23, 2013  
File Reference No. PCC-13-03

We agree that a reporting entity that applies the simplified hedge accounting approach to an interest rate swap should provide the disclosures required under ASC 815 and ASC 820. Furthermore, we would not object to an entity's disclosing settlement value instead of fair value whenever applicable.

*Question 13: Do you agree with providing an entity-wide accounting policy election for applying the combined instruments approach? If that policy election is available, 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.*

We do not support the use of the combined instruments approach.

The simplified hedge accounting method and the existing hedging model under ASC 815 are conceptually superior to (and more transparent than) the combined instruments approach. Therefore, if the Board ultimately permits the combined instruments approach, it should allow nonpublic entities to use these superior models if they desire to do so (i.e., they should not be compelled to use a less transparent model).

We further recommend that if the combined instruments approach is ultimately adopted, its use should be limited to those qualifying swaps entered into on or after the date of adoption (i.e., its use should not be available for swaps that already exist on the adoption 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.*

If the combined instruments approach is retained, its use should be (1) on a transaction-by-transaction basis and (2) limited to those qualifying swaps entered into on or after the date of adoption (i.e., its use should not be available for swaps that already exist on the adoption date) (see Question 13).

We do not support an entity-wide accounting policy election to apply the combined instruments approach. However, if the Board retains that concept in the final ASU, it should specify a narrower time frame for when entities can make that determination (e.g., "within a week" instead of "within a few weeks").

*Question 15: Do you agree that the simplified hedge accounting approach could be elected for any qualifying swaps, whether existing at the date of adoption or entered into on or after the adoption date? If not, please explain why.*

We believe that entities should be able to apply the simplified hedge accounting approach to (1) future qualifying swaps and (2) qualifying swaps designated in existing cash flow hedging relationships under ASC 815-20 on the date of adoption.

We believe that a reporting entity should be required for those swaps in category (2) above to dedesignate the existing hedge and redesignate a new hedging relationship under the simplified hedge accounting approach (i.e., essentially prospectively apply the simplified hedging approach). We agree that for those

Page 8  
August 23, 2013  
File Reference No. PCC-13-03

redesignated hedging relationships, the swap should not be required to have a fair value of zero or close to zero on the date of redesignation when it is coincident with the adoption date of the standard.

Furthermore, amounts previously deferred in accumulated other comprehensive income (AOCI) would remain in AOCI until the hedged item affects earnings (unless it becomes probable that the originally forecasted transaction will not occur). An entity would be able to assume no hedge ineffectiveness in the hedging relationship prospectively (i.e., after redesignation under the simplified hedge accounting approach).

We do not support suspension of the requirement that the swap's fair value at redesignation be zero or close to zero in transition, unless the swap was designated in a qualifying cash flow hedging relationship under ASC 815 immediately before the adoption date. We do not believe it is appropriate for entities to retrospectively apply hedge accounting with the benefit of hindsight.

*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.*

Please see our response to Question 15.

*Question 17: Do you agree that the formal documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed within a few weeks of hedge designation under the simplified hedge accounting approach? If not, please explain why.*

We do not believe it is appropriate for an entity to apply hedge accounting until it has made an election to do so and concluded that the scope requirements have been met. Accordingly, an entity should at least have some form of documentation to that effect in place before it applies hedge accounting. Some entities may face practical challenges in compiling all of the required hedge documentation at the inception of a hedging relationship; therefore, we would not object if the final ASU permits such entities to finalize their hedge documentation within a short period after the inception of the hedging relationship. Though the Board is reluctant to establish "bright-line" guidance (as indicated in paragraph BC17), it should narrow the time frame during which this practical expedient may be applied or provide indicators of the reasonable boundaries of this range to prevent potential abuse (e.g., "within a week" instead of "within a few weeks").

*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.*

Page 9  
August 23, 2013  
File Reference No. PCC-13-03

We believe that the provisions of the final ASU should be applied prospectively. Prospective application of amendments to the hedging guidance is consistent with historical practice (e.g., ASU 2013-10), and we do not believe it is appropriate for entities to retrospectively apply the provisions of the final ASU with the benefit of hindsight.

We believe that entities should be able to apply the simplified hedge accounting approach to (1) future qualifying swaps and (2) qualifying swaps designated in existing cash flow hedging relationships under ASC 815-20 on the date of adoption (see Question 15). We do not support the retrospective or modified retrospective transition methods.

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

We believe that since the Board is offering the proposed accounting alternatives for nonpublic entities, it is less concerned with comparability among nonpublic entity financial statements. Therefore, we would not object if the Board permits early adoption of the final ASU.

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

Preparers of financial statements are best positioned to respond to this question. However, because the proposal reduces the complexity of applying existing accounting standards, a one year adoption period should provide most preparers with sufficient time to implement the new requirements.

*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.*

Page 10  
August 23, 2013  
File Reference No. PCC-13-03

*Do you agree with the Board's tentative decisions reached about the definition of a public business entity? If not, please explain why.*

We intend to answer this question in our comment letter for the Board's recently issued proposed ASU *Definition of a Public Business Entity: An Amendment to the Master Glossary*.