



August 23, 2013

Technical Director  
Financial Accounting Standards Board  
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Via e-mail – [director@fasb.org](mailto:director@fasb.org)

Re: File Reference No. PCC-13-03. Proposed Accounting Standards Update: Derivatives and Hedging (Topic 815): *Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps – a Proposal of the Private Company Council*

Plante & Moran PLLC (Plante Moran) is the 11<sup>th</sup> largest public accounting firm in the United States and serves a wide range of non-public entities in multiple industries. We appreciate the efforts of the Private Company Council (PCC) and the Financial Accounting Standards Board (Board) to address the unique needs and financial reporting characteristics of private entities. Following, please find our responses to the specific Questions for Respondents in the above referenced Exposure Draft, along with an additional following comment.

**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.

**Response 1:** Plante Moran is a public accounting firm with approximately 270 partners and over 2,000 staff. While we serve both public and private entities, a significant portion of our practice is devoted to private entities in numerous industries.

**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.)

**Response 2:** No, we do not agree that the scopes of both approaches should exclude financial institutions, per se. We do not believe that the reasons cited in paragraph BC10 of the Basis for Conclusions to the Proposed Update support the exclusion. First, it is indicated that financial institutions generally use numerous derivative instruments and a special accounting model for only certain types of swaps would be confusing to users. In our experience, other entities included in the scope of this Proposed Update can also have numerous other derivatives. Use of the proposed guidance would be no more confusing to the users of financial statements of financial institutions than to the users of financial statements of other entities that have multiple types of derivatives and are included in the scope of this Proposed Update.

Second, it is indicated that financial institutions generally have adequate resources to comply with current U.S. GAAP requirements in Topic 815. While limited resources were cited in paragraph BC4 as a reason for proposing the Update, the availability or lack of resources is not a scope consideration for other entities.

Third, it is indicated that financial institutions are typically regulated industries and there could be unintended regulatory consequences in providing the alternative. We do not believe that determinations about generally accepted accounting principles should be based on regulatory needs. If the PCC and the Board believe that an accounting principle is appropriate for a type of entity, the determination of whether regulated entities will be permitted to follow the principle should be left to the regulators.

Perhaps a better defining criteria for such an exclusion would be, for example, entities that participate in other than trivial interest rate arbitrage activities or entities that have adopted the fair value option for any of their long-term debt. The objective would be to find some characteristic indicating a complexity associated with interest rates or financing, the existence of which would make the accounting alternative inappropriate. It might be that entities that are financial institutions would not qualify for the alternative more than other industries under this criteria approach; however, we would urge the PCC to focus on defining criteria, rather than an entire industry.

**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.

**Response 3:** We believe that the scope of the accounting alternative should be extended to not-for-profit entities without modification. While certain not-for-profit entities have some form of public accountability (resulting from the solicitation of contributions from the public, use of public funds in the form of grants, or other activities) not-for-profit entities in general are more similar to

private entities than public entities. In particular, our experience has been that the users of not-for-profit entity financial statements have similar needs as users of private company financial statements and would benefit from the accounting alternative. We acknowledge that the Board currently has projects on its active agenda to address several aspects of financial reporting for not-for-profit entities that could affect the accounting for interest rate swaps. However, until those projects are completed, we believe that not-for-profit entities should be able to elect the combined instruments approach or the simplified hedge accounting approach.

With respect to public companies, we do not believe it would be appropriate at this time to extend the accounting alternative to these entities. While users of public company financial statements may have the same concerns as users of private company financial statements, the Board and the International Accounting Standards Board have invested significant time and resources toward convergence of US GAAP and the International Financial Reporting Standards (IFRS) and the accounting alternatives for interest rate swaps would create potentially significant differences with IFRS. We would suggest that an appropriate time to consider the accounting alternative for public companies would be after the completion of the Joint FASB/IASB Projects.

**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.

**Response 4:** Yes, we agree with the required criteria for applying the combined instruments approach and the simplified hedge accounting approach; however, we believe the PCC and the Board should consider providing additional guidance on the intended meaning of phrase "at or near zero" as used in paragraphs 815-20-25-131D(d) and 815-50-15-2(d). While a bright line test is not necessary, guidance on the intended meaning would provide more consistency to practice. The relatively vague meaning of "at or near zero" could create divergence in practice as well as difficulty in auditing. For example, an entity may refinance debt with an existing interest rate swap with a new lender while at the same time entering into a new swap arrangement. When the original swap includes a cancellation penalty, it is not uncommon for the new lender to pay the penalty on behalf of the entity and include this amount in the basis of the new swap that is issued at approximately the same time (within days) of the new debt. This results in the new swap having a fair value that is not zero at issuance and there will be a need to evaluate the significance of the fair value of the swap to determine whether it meets the criteria for the fair value of the swap to be "at or near zero" at inception. We believe that this issue can be addressed through the inclusion of implementation guidance in the proposed standard.

**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.

**Response 5:** We do not agree with the differences in criteria for applying the combined instruments versus the simplified hedge accounting approach. The primary difference between the combined instruments approach and the simplified hedge accounting approach is that the term of the swap is required to approximate the term of the borrowing under the combined instruments approach, whereas the term only needs to be equal to or less than the term of the borrowing under the simplified hedge accounting approach. Paragraph BC11 in the Basis for Conclusions to the Proposed Update indicates that the combined instruments approach was

intended for those swaps entered into by an entity "for the purpose of economically converting a variable-rate borrowing to a fixed-rate borrowing." However, we do not believe that the use of the combined instruments approach should be limited to circumstances where the term of the swap approximates the term of the borrowing. If an entity enters into a swap with a term that is shorter than the debt with the intent to only convert the borrowings to a fixed-rate for that period of time, we do not believe that use of the combined instruments approach would be inappropriate. To the extent that the relationship is effective for that period of time, we believe either approach would be a reasonable alternative.

**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.

**Response 6:** No, we do not believe that additional criteria about management's intent to hold the swap to maturity be included. In our experience, private entities generally only enter into swap arrangements with the intention of holding the swap to maturity, unless the corresponding debt is repaid early or refinanced. Furthermore, based on our Response to Question 5, we do not believe that the combined instruments approach should be limited to situations where an entity has effectively obtained fixed-rate borrowing for the term of the debt. As such, management's intent to hold a swap to maturity should not be a limiting criterion to using the combined instruments approach.

**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.

**Response 7:** Yes, we agree that there should be a requirement related to the risk of counterparty default. In the case of a fixed-rate debt instrument, there is little to no risk related to counterparty default; the default risk is borne by the lender almost exclusively. While an interest rate swap eligible for the combined instruments approach effectively results in the borrower having a fixed rate debt instrument, the borrower also assumes some risk of counterparty default, which is not present in a true fixed-rate borrowing arrangement. Because counterparty default can eliminate the benefit obtained from the swap arrangement, we believe it should be included as a requirement to qualification for the combined instruments approach. Furthermore, by adding counterparty default risk as a requirement for the combined instruments approach, there will be further convergence of the requirements for the combined instruments approach and the simplified hedge accounting approach, which we believe should be acceptable alternatives for any qualifying swap arrangement.

**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.

**Response 8:** Yes, we agree.

**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.

**Response 9:** Yes.

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

**Response 10:** No. We believe the costs of obtaining and auditing settlement value are substantially similar to fair value. In current practice, many entities obtain an estimate of settlement value from the counterparty and make adjustments, as necessary, for nonperformance risk of the swap counterparty to determine fair value. In our experience, adjustments for nonperformance risk are uncommon as the swap counterparty is typically the lender, which are often large banks. Settlement value to fair value adjustments would be more likely to occur during economic downturns that affect the viability of large banks, or if parties other than the lender are the swap counterparty.

**Question 11:** Do you agree that the following should be disclosed if the combined instruments approach is applied and that no additional disclosures should be required? If not, please explain why.

- a. The settlement value of the swap (along with the valuation method and assumptions)
- b. The principal amount of the borrowing for which the forecasted interest payments have been swapped to a fixed rate and the remaining principal amount of the borrowing that has not been swapped to a fixed rate
- c. The location and amount of the gains and losses reported in the statement of financial performance arising from early termination, if any, of the swap
- d. The nature and existence of credit-risk-related contingent features and the circumstances in which the features could be triggered in a swap that is in a loss position at the end of the reporting period.

**Response 11:** We agree that the disclosures described above should be provided if the combined instruments approach is applied. In addition, we believe that disclosure of how the swap will be accounted for in the event the combined instruments approach is no longer applicable, along with the nature of the events that could result in discontinuance of the combined instruments approach, should be provided to inform users of the potential effects on the financial statements.

Finally, given the number of options a private entity will have to account for interest rate swaps assuming the guidance in the Proposed Update is finalized, appropriate accounting policy disclosures will be of utmost importance in ensuring that financial statement users understand the accounting alternative elections a private entity has made in preparing its financial statements. We believe that the current requirements in ASC 235-10-50 provide adequate guidance regarding the need to disclose accounting policies. Nevertheless, given the significance of the accounting policy disclosures, we recommend that a cross-reference to the accounting policy disclosure

requirements in ASC 235-10-50 be considered in the disclosure requirements in the Proposed Update. A sample accounting policy disclosure for an entity that has elected to use the accounting alternative should also be considered in the implementation guidance in the Proposed Update.

**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.

**Response 12:** Yes, we agree.

**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.

**Response 13:** We do not agree with providing an entity-wide accounting policy election for applying the combined instruments approach. While we believe that consistency in the accounting for interest rate swaps would be in the best interest of financial statement users, private entities have different accounting options under current US GAAP that would be expanded under the Proposed Update. Our reasoning for not requiring an entity-wide accounting policy election for applying the combined instruments approach is that the approach would only apply to qualifying swaps and an entity would have the ability to easily modify the terms of a swap if it did not want to use the combined instruments approach. As such, we believe that a private entity should have the ability to elect to use the combined instruments approach on an instrument-by-instrument basis. This further reinforces the need to ensure adequate accounting policy disclosures are included in the financial statements as described in our Response to Question 11.

With respect to the date of adoption of the guidance in the Proposed Update, we would likewise believe that entities should have the ability to elect to apply the combined instruments approach on an instrument-by-instrument basis for swaps existing at that date.

**Question 14:** Do you agree that the entity-wide accounting policy election to apply the combined instruments approach must be made upon adoption of the amendments in this proposed Update or, for entities that do not have existing eligible swaps, within a few weeks after the entity enters into its first transaction that is eligible for the accounting policy election? If not, please explain why.

**Response 14:** No. As described in our Response to Question 13, we believe entities should have the ability to elect the combined instruments approach on an instrument-by-instrument basis. However, should the PCC and the Board conclude that the combined instruments approach should be applied on an entity-wide basis, we believe that the approach should be applied to all qualifying swaps held at a particular point in time. This would mean that should an entity enter into a new swap meeting the criteria for the combined instruments approach (a

“qualifying swap”) at the same time it has another qualifying swap accounted for using the combined instruments approach, the new qualifying swap would be required to be accounted for using the combined instruments approach. However, if in a subsequent period the entity enters into a new qualifying swap but has no other qualifying swaps accounted for using the combined instruments approach at that time, the entity could elect to, but would not be required to, use the combined instruments approach for the new qualifying swap.

**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.

**Response 15:** Yes. We 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. In addition, and as discussed in our Responses to Questions 13 and 14, we believe the same treatment should be applied to the combined instruments approach.

**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.

**Response 16:** Yes, we agree that the election to apply the simplified hedge accounting approach to an existing qualifying swap must be made upon adoption of the amendments to the Proposed Update.

**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.

**Response 17:** We agree that the formal documentation required by paragraph 815-20-25-3 must be completed within a few weeks of hedge designation under the simplified hedge accounting approach. However, we also believe that the PCC and the Board should consider reducing the documentation requirements for the simplified hedge accounting approach to only include those elements necessary to validate that the instrument meets the requirements of the approach.

**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.

**Response 18:** Yes, we agree that entities should be provided with the option to apply the amendments in the Proposed Update using either a modified retrospective approach or a full retrospective approach. Given the potentially significant changes that could result from application of the new guidance, we believe the full retrospective approach would be preferred;

however, acknowledging the limited resources of many private entities and the well-established practice of modified retrospective application in other new Board guidance, we agree that the modified retrospective approach should also be made available.

**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.

**Response 19:** Yes, we agree entities should be permitted to early adopt the proposed amendments.

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

**Response 20:** We do not believe that the time needed to implement the proposed amendments would be significant as the information needed to apply either the modified retrospective approach or full retrospective approach would be known or easily accessible.

**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.

**Response 21:** We do not agree with the Board's tentative decisions reached about the definition of a public business entity. For conduit bond obligors, we believe that the conclusion should be based on (1) whether the securities are unrestricted and can be traded on an exchange or over-the-counter market; **and** (2) whether the business entity is required to or elects to make its financial statements publicly available.

In the proposed definition of a public business entity, criteria (a), (b) and (d) are predicated on whether the entity is required to make its financial statements publicly available. Assuming an entity is under the aggregate debt limits of SEC Rule 15c2-12 and has not agreed in the initial offering document to make its financial statements publicly available, the entity is not required to make its financial statements available to investors in the conduit bonds. The treatment of all conduit debt obligors with unrestricted securities that can be traded on an exchange or an over-the-counter market as public business entities is inconsistent with the premise that making financial information publicly available is the defining characteristic of a public business entity. Accordingly, we do not believe conduit debt obligors should be considered public business entities unless the entity's financial statements are made publicly available.

Lastly, we would expect that only entities with little or no expectation of becoming a public business entity will elect to use either the combined instruments approach or the simplified hedge accounting approach for interest rate swaps. We would also expect that occasionally a business entity that has adopted the alternative will move into the public arena. The proposed guidance is silent with respect to this circumstance. We therefore believe that the effect of this situation would result in a need to reflect an accounting change in the financial statements in the year of the change under ASC 250-10. We do, however, recommend that guidance be added regarding this situation.

Thank you again for the opportunity to comment on this exposure draft. We would be pleased to respond to any questions the PCC, the Board or its staff may have about these comments. Please direct any questions to Joan Waggoner ([joan.waggoner@plantemoran.com](mailto:joan.waggoner@plantemoran.com) or 312.980.2945), or David Grubb ([david.grubb@plantemoran.com](mailto:david.grubb@plantemoran.com) or 248.223.3745).

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