

Private Company Financial Reporting Committee

401 Merritt 7, PO Box 5116, Norwalk, Connecticut 06856-5116

443-480-5800

e-mail: judyodell@dmv.com



Judith H. O'Dell CPA CVA
Chair

April 26, 2011

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856

Re: Invitation to Comment, *Selected Issues about Hedge Accounting* (“Invitation to Comment”)

Dear Ms. Seidman:

In connection with the FASB's issuance of the Invitation to Comment, the Private Company Financial Reporting Committee (“PCFRC”) offers its recommendations below about hedge accounting in the private company sector. Although the FASB's purpose in issuing the Invitation to Comment is to solicit comments on the IASB's proposed revisions to IAS 39, the Board's ultimate goal is to improve and simplify its hedge accounting guidance. In that light, the FASB staff encouraged the PCFRC to provide input about the application of hedge accounting at private companies.

The PCFRC is largely focused on and concerned with the accounting and reporting for interest rate swaps, and by extension, to related caps and collars. Interest rate swaps are common among private companies, especially instruments that swap floating interest rates to fixed interest rates. Most often, these instruments are connected to real estate and equipment loans and are long-term contracts (ten-fifteen years) and are held to maturity. These swaps are different than other derivative contracts in that there are no margin calls for borrowers that are "out-of-the -money" on a mark-to-market basis. Thus a cash flow impact only occurs when there is an early termination of the swap. Early termination does happen but only on a small percentage of the swaps. The underlying collateral of the note secures both the loan and the swap contract. Private company financial statement users are interested in what the actual cash flows are related to these instruments, which is basically the fixed rate of interest.

As stated above, in the private company sector interest rate swaps are most often connected to real estate and equipment loans and held to maturity. As such, requiring mark-to-market accounting in those situations would not produce relevant information for private company financial statement users and would add needless cost to preparers. Also, adjusting to fair value results in the recording of amounts in net income

or in other comprehensive income that accomplish little more than adding “noise” to the financial statements. In most cases, these amounts are reversed out by private company financial statement users to eliminate the noise and obtain a clearer picture of relevant information. Disclosure of the commitment and perhaps the termination liability would be sufficient to meet the needs of the users of the financial statements. In situations where it is probable that a private company is going to exit the swap, then recording the liability and expense would be appropriate.

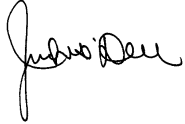
The PCFRC wishes to highlight the fact that the accounting treatment for a straight fixed-rate debt instrument (carrying value) is different than the accounting treatment for a “synthetic” fixed-rate debt instrument (variable rate converted to fixed rate with a swap – effectively held at fair value) even though the underlying substance is exactly the same if held to maturity. In the private company sector, many fixed rate loans have an economic prepayment penalty; also call a yield maintenance penalty. In essence the computation of the penalty is very similar to the mark-to-market cost of an early termination of a floating- to fixed-rate swap. Therefore the termination liability for a fixed-rate loan is almost the same as the termination liability of a swap. The only difference in the two is that there is an upside to the swap at termination if the swap is in-the-money. These in-the-money positions are rarely taken advantage of unless the underlying asset is sold because the cost of money to refinance negates the gain on the swap

As the FASB moves forward in developing changes to hedge accounting, the PCFRC recommends that a simplified approach to the accounting and reporting for interest rate swaps and their related caps and collars be considered for private companies. Any proposed changes should avoid a high volume of accounting over the long life of these instruments. Measuring hedge effectiveness and allocating gain or loss to net income and other comprehensive income over the life of these instruments would be costly and time-consuming for private companies. The accounting would not produce information that would be relevant or decision-useful to private company financial statement users, who focus on cash flow and eliminate hedge effectiveness valuations from their analyses. Ideally, the accounting for these instruments should result in recognizing the interest on the basis of the swap –usually variable to fixed interest, therefore recognizing interest on a fixed basis.

The PCFRC’s recommendations related to hedge accounting parallel our comments about the FASB’s proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. The accounting for financial instruments should portray economic substance and reflect an entity’s business strategy, the manner in which financial instruments are managed, and expected cash flows. Management’s intent is key. If the intent is to hold an instrument for collection or payment of the contractual cash flows, a fair value measurement basis would be irrelevant to the users of the financial statements. Moreover, the changes in fair value would introduce needless volatility into the financial statements that users would find distracting.

The PCFRC appreciates the FASB's consideration of these comments and recommendations. Please feel free to contact me if you have any questions or comments.

Sincerely,

A handwritten signature in black ink, appearing to read "Judith H. O'Dell". The signature is fluid and cursive, with the first name "Judith" being the most prominent part.

Judith H. O'Dell
Chair
Private Company Financial Reporting Committee