

November 22, 2016

Susan M. Cospers, CPA  
Technical Director  
FASB  
401 Merritt 7  
PO Box 5116  
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**Re: FASB September 8, 2016 Proposed Accounting Standards Update *Derivatives and Hedging (Topic 815) Targeting Improvements to Accounting for Hedging Activities* [File Reference No. 2016-310]**

Dear Ms. Cospers:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815) Targeting Improvements to Accounting for Hedging Activities* (ED) and is providing the following comments for your consideration. TIC is only providing comments on those questions where we felt it necessary to provide our viewpoints.

### **GENERAL COMMENTS**

TIC agrees with the objectives of this ED, which are to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in this ED would make certain targeted improvements to simplify the application of the hedge accounting guidance in current U.S. GAAP based on the feedback received from preparers, auditors, users, and other stakeholders. However, TIC believes that the initial quantitative effectiveness testing portion and related quarterly documentation requirements add undue cost and complexity for entities that only prepare financial statements on an annual basis. TIC is providing our detailed feedback in the following letter.

## SPECIFIC COMMENTS

**Question 1:** *The Board decided it would allow an entity to designate the hedged risk as the variability in cash flows attributable to changes in a contractually specified component stated in the contract in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset. Do you agree with that decision? Please explain why or why not. If not, what specific alternatives should the Board consider? Please explain why those alternatives would be beneficial.*

TIC agrees with the Board's proposed decision on this matter. TIC believes allowing an entity to hedge a contractually specified component stated in the contract will more closely align hedge accounting with an entity's actual risk management strategies.

**Question 2:** *The Board decided that it would retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments and forecasted issuances or purchases of fixed-rate financial instruments, maintain the existing list of permissible benchmark rates, and add the SIFMA Municipal Swap Rate to the list.*

*(a) Should the Board retain the current concept of benchmark interest rates for fair value hedges of fixed-rate financial instruments and for cash flow hedges of forecasted issuances or purchases of fixed-rate financial instruments? Please explain why or why not.*

TIC agrees with the Board's proposed decision to retain the current concept of benchmark interest rates for fixed-rate financial instruments and to discontinue the concept for variable-rate financial instruments. As explained in BC 99, TIC agrees that benchmark rates should incorporate a low level of interest rate risk, which is not always easy to apply in practice for variable-rate financial instruments. Additionally, by removing the benchmark requirement from variable-rate financial instruments, this should reduce the number of workarounds currently in place to maintain hedging effectiveness for variable-rate financial instruments and in the process reduce the level of complexity in accounting for those financial instruments.

*(b) If the Board continues to maintain the current concept of benchmark interest rates, should the Board consider within the concept expectations that a rate will become widely used?*

TIC agrees that if the current concept of benchmark interest rates continues, the Board should consider within the concept expectations that a rate will become widely used.

*(c) If the Board continues to maintain a list of rates, are there any other rates that should be added to the list? Please explain why a particular rate meets the definition of a benchmark rate.*

TIC is not aware of any additional rates that should be added to the list today. However, the Board should consider a process where additional rates that meet the criteria of a risk free rate may be added to the list of acceptable rates, as additional rates are identified in the future.

*(d) Are there other alternatives to the current concept of benchmark interest rates the Board should consider (for example, a principles-based approach)? Please describe those alternatives.*

TIC agrees with the Board's concerns in BC98 that removing benchmark interest rates and switching to a principles-based approach would introduce many additional benchmarks that could potentially introduce a high level of credit risk into the model.

**Question 3:** *The Board decided that it would allow an entity to use either the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in fair value of the hedged item attributable to interest rate risk, except when the current market yield of the financial instrument is below the benchmark rate at hedge inception. In that instance, the total contractual coupon cash flows would have to be used. Do you agree with this decision? Please explain why or why not.*

TIC agrees with the Board's proposed decision as it lines up with management's risk management objective in entering into hedging instruments.

**Question 6:** *Do you agree with the following Board decisions on presentation? Please explain why or why not. If not, what other alternatives should the Board consider?*

*(a) For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would modify current U.S. GAAP by requiring the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is presented.*

*(b) For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would retain current U.S. GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded currently in earnings. For qualifying fair value and cash flow hedges, the proposed amendments would modify current U.S. GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. For qualifying net investment hedges, there will be no prescribed presentation requirements for changes in the fair value of the hedging instrument excluded from the assessment of effectiveness.*

*(c) For cash flow hedges in which the hedged forecasted transaction is probable of not occurring, the proposed amendments would retain current U.S. GAAP by requiring amounts recorded in accumulated other comprehensive income to be reclassified to earnings immediately. However, the proposed amendments would require presentation of reclassified amounts in the same income statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.*

TIC agrees with the Board's decision on presentation and believe it better aligns with an entity's risk management strategies and goals and the particular items being hedged. TIC also believes that the proposed ASU improves financial reporting by increasing comparability between reporting entities by specifying where these items would be presented in the financial statements after reclassification. Current U.S. GAAP does not get into specific geography on the income statement when items are classified out of Other Comprehensive Income (OCI) and onto the income statement, so this would decrease the current diversity in practice.

**Question 7:** *Do you agree with the proposed disclosure amendments in (a), (b), and (c) below? Please explain why or why not.*

- (a) Cumulative basis adjustments related to fair value hedges*
- (b) Quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it meets those goals*
- (c) Revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items*

TIC agrees with the proposed disclosure amendments in (a) and (c) above, as they provide relevant and useful information to financial statement users. TIC is concerned that amendment (b) could infringe on information deemed proprietary to an entity's risk management and hedging program if quantitative information is disclosed. TIC would like to propose an exemption for private companies from being required to provide the information in amendment (b). As an alternative, the Board might consider requiring all entities to provide more qualitative information related to the information in amendment (b) as opposed to quantitative information.

**Question 8:** *Unless the hedging relationship meets one of the exceptions that assumes perfect offset at hedge inception, an entity would be required to perform an initial quantitative test of hedge effectiveness and would be allowed to perform subsequent hedge effectiveness assessments qualitatively unless facts and circumstances change. Do you agree with this proposed change? Please explain why or why not.*

TIC agrees with this proposed change as using a qualitative test of hedge effectiveness would simplify the hedging methodology used in demonstrating hedge effectiveness for all entities.

**Question 9:** *The Board decided that an entity may elect at hedge inception to perform subsequent assessments of effectiveness qualitatively. However, certain changes in the facts and circumstances associated with the hedging relationship in subsequent periods may require a quantitative assessment of effectiveness to be performed. Once an entity determines that a quantitative assessment of effectiveness is required, the entity would be prohibited to return to qualitative testing in periods after this determination is made. Can situations arise in which an entity no longer may assert qualitatively that the hedging relationship continues to be highly effective but when tested quantitatively would be highly effective? If so, please describe those circumstances. Should an entity be allowed to return to qualitative testing after such a significant change in facts and circumstances precluded it in a prior period? If so, please discuss the factors that an entity should consider to justify a reasonable expectation that the hedge will once again be highly effective on a qualitative basis.*

TIC believes an entity should be able to return to using a qualitative assessment if facts indicate that the entity's effectiveness criteria have been re-stabilized and a sufficient period of time has passed to demonstrate that the hedge is again highly effective. TIC cannot provide any examples to demonstrate the situation described above, although TIC does agree with the theory.

**Question 10:** *Do you agree with the proposed amendment that would allow an entity to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date using data applicable as of the date of hedge inception? Please explain why or why not.*

While TIC supports relief provided with the proposed amendment to allow an entity to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date, TIC believes additional relief should be granted to private companies. TIC members believe that the effectiveness testing requirements (both initial and ongoing) portion of the hedge documentation should be performed in association with an entity's reporting cycle, rather than required for all entities on a quarterly basis.

TIC feels that the quarterly requirement is more applicable to public companies that are required to file quarterly financial statements and would introduce additional cost and complexity for entities that only prepare annual financial statements. Therefore, TIC feels that entities that only prepare annual financial statements should be permitted to perform the initial quantitative testing portion of hedge documentation as well as the ongoing effectiveness testing at any time between hedge inception and the date their financial statements are issued or available to be issued. This also is consistent with the current guidance available to private entities in the PCC Accounting Alternative in ASU 2014-03, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach*.

In applying the simplified hedge accounting approach, the documentation required by FASB ASC 815-20-25-3 to qualify for hedge accounting must be completed by the date on

which the first annual financial statements are available to be issued after hedge inception rather than concurrently at hedge inception.

Further, the following was noted in the Basis for Conclusions in ASU 2014-03:

“The PCC obtained stakeholder feedback that completing documentation within “a few weeks” could be an administrative burden for private companies because many do not consider the accounting implications of significant contracts such as long-term debt and swap agreements until preparing the annual financial statements. In addition, the PCC observed that many private companies lack the expertise and accounting resources and may require the assistance of a public accountant or a third party to comply with the documentation requirements in Topic 815.”

TIC believes that this applies not only to “plain-vanilla” interest rate swaps that are currently covered under ASU 2014-03, but the same concerns apply to more complex derivatives and hedging transactions that fall under FASB ASC 815.

**Question 11:** *The proposed amendments related to the timing of the preparation of hedge documentation and subsequent qualitative testing apply to both public entities and private companies. Are there valid reasons why the content of, or the timing of, the preparation of hedge documentation should be different for public entities and private companies? If so, please describe the specific types of transactions for which different treatment should be considered.*

As noted in Question 10 above, TIC believes that the timing of the preparation of hedge documentation and subsequent testing should be consistent with an entity’s reporting cycle, whether they be public or private. TIC believes that for private entities, it is introducing additional cost and complexity to prepare this documentation outside of their normal reporting cycle, which for many private entities means on an annual basis.

**Question 12:** *Should the effective date be the same for both public business entities and entities other than public business entities?*

TIC believes the effective date should be different between public business entities (PBEs) and entities other than PBEs. Even though certain private entities already may have existing hedging programs in place, we believe private entities would still benefit in having an additional year to implement the proposed ASU and learn from any implementation challenges experienced by PBEs. Therefore, TIC would propose that the effective date for private entities be one year after the effective date for PBEs.

**Question 13:** *How much time is needed to implement the proposed amendments? Should entities other than PBEs be provided more time? If so, how much more time?*

TIC recommends that entities be allowed a year from issuance of the final ASU to adopt the new standard, as it would allow them sufficient time to manage the multiple large projects that will become effective in U.S. GAAP in the next few years.

**Question 14:** *Do you agree with the proposed transition method and disclosures in FASB ASC 815-20-65-3? Do you agree with the Board's decision not to allow a retrospective transition approach? Please explain why or why not.*

TIC agrees with the proposed transition method and disclosures in FASB ASC 815-20-65-3. TIC also agrees with the Board's decision to utilize a modified retrospective basis for existing hedges, instead of allowing a retrospective transition approach, to reevaluate hedging relationships. Utilizing a retrospective transition approach would be extremely difficult and burdensome to apply in reevaluating those relationships to prior periods in determining hedge effectiveness under the proposed ASU.

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

Sincerely,

A handwritten signature in black ink that reads "Michael A. Westervelt". The signature is written in a cursive, slightly slanted style.

Michael A. Westervelt, Chair  
PCPS Technical Issues Committee  
cc: PCPS Executive and Technical Issues Committees