Grant Thornton

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Via Email to director@fasb.org

Re: File reference number 2016-310

Dear Ms. Cosper:

Grant Thornton LLP appreciates the opportunity to comment on the FASB's Proposed Accounting Standards Update (ASU), *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. We support the Board's efforts to improve financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements, and to simplify the application of hedge accounting guidance in US GAAP.

In addition to our responses to the questions in the proposed ASU, we would like to highlight two potential amendments that we believe would improve the hedge accounting model under US GAAP.

First, we believe that the Board should eliminate the shortcut method for assessing hedge effectiveness. The proposed guidance would permit entities to (1) qualitatively assess hedge effectiveness subsequent to hedge designation, and (2) apply a "critical terms match" approach that presumes the hedging relationship is perfectly effective. In our view, this expanded ability for entities to qualitatively assess hedging relationships on an ongoing basis largely obviates the need to retain the shortcut method. In our experience, the shortcut method is used infrequently, and although the proposed relief from failing to qualify for the shortcut method after its initial application might increase its use, we believe that its primary benefits can be obtained through the qualitative assessment and critical terms match options.

We understand that stakeholders have expressed concern to the Board that eliminating the shortcut method would increase costs for preparers and provide little benefit to users. It does not seem to us that there is a significant difference in costs associated with applying the shortcut and critical terms match methods of assessing hedge effectiveness, and that more care is needed in determining whether an arrangement qualifies for the shortcut method as opposed to the critical terms match method. We believe that the hedge accounting guidance could be simplified by eliminating the shortcut method without sacrificing the benefits to preparers and users of a simplified, qualitative method for applying hedge accounting.

Second, we believe the Board should provide entities with the option to account for the cumulative change in fair value of the hedging instrument in a cash flow hedge of a forecasted purchase of a nonfinancial asset as either an adjustment to the basis of that nonfinancial asset or as a component of accumulated other comprehensive income. Such a provision would be consistent with guidance in IAS 39, *Financial Instruments: Recognition and Measurement*, and would simplify the subsequent accounting for certain entities by allowing use of existing inventory and fixed asset accounting systems to recognize the effects of the hedge in earnings (for example, through depreciation or cost of goods sold calculated using an adjusted asset basis).

Our responses to selected questions for respondents follow.

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.

We agree with the Board's decision, but we suggest modifying the definition of a "contractually specified component" to include components that are specified by statute or regulation, such as excise and sales taxes. Although such components might not be specified in a contract, it is our view that they are objectively verifiable, and hedges of nonfinancial items that are adjusted for these components should be eligible for hedge designation.

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.**

   We believe the Board should 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 instruments. We agree with the Board's concern that broadening the scope of eligible interest rate indexes could result in entities hedging interest rate indexes that incorporate significant credit risk.

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?**

Yes, we believe the Board should consider 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.**

We are not aware of any other rates that should be added to the list of benchmark interest rates.

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.**

We do not believe there are other alternatives the Board should consider.

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 the 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.

We agree with this decision.

Question 4: In regard to hedging forecasted transactions, paragraph 815-30-40-5, as amended, states that "a pattern of determining that hedged forecasted transactions are probable of not occurring would call into question both an entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions." What is your policy on what constitutes a pattern? Are there certain instances or scenarios in which missed forecasts should not be incorporated into the consideration of this pattern?

In our view, whether a "pattern of determining that hedged forecasted transactions are probable of not occurring" exists is a matter of judgment. For example, if an entity has only a few hedged forecasted transactions in a period, then as little as two instances of hedged forecasted transactions being deemed probable of not occurring might constitute a pattern. However, if an entity has hundreds of hedged forecasted transactions in a period, then the threshold for identifying a pattern of determining that hedged forecasted transactions are probable of not occurring might be higher.

We believe that this process of determining whether a pattern exists is inherently judgmental and we encourage the Board to exercise caution in developing prescriptive guidance in this area.

Question 5: Are there hedging relationships that would be eligible to meet the requirements in the proposed amendments and IFRS 9, but the hedge results would be recognized and presented differently? If so, please describe the transaction and why it would be recognized and presented differently in accordance with IFRS 9.

We believe that the presentation for many hedges could differ under the proposed guidance and IFRS 9 due to the proposed requirement to report the entire effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. IFRS 9 does not include a similar presentation requirement.

Also, under IFRS 9 an entity is required to adjust the basis of a purchased nonfinancial asset to incorporate the cumulative change in fair value of the hedging instrument when that purchase is designated as a hedged item, whereas the proposed guidance does not permit such basis adjustments.

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 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 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 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 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**

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statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.

We agree with these decisions.

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 met 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.**

We agree with these proposed disclosure amendments.

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.

We agree with this proposed change, although we believe the examples in ASC 815-20-55-79G through 55-79N should provide quantitative examples to more clearly demonstrate what is meant by being close to failing the effectiveness test and changes being highly correlated. We understand that the Board has historically been reluctant to specify numerical thresholds for high effectiveness, but we note that (1) practice has defined these numerical thresholds in the US and (2) internationally, IAS 39 specified similar numerical thresholds. We are not aware of adverse consequences associated with the IASB's decision to specify high effectiveness in IAS 39, and it is our view that 80 percent and 125 percent thresholds for correlation have worked well in the US to establish a highly effective hedging relationship. Under the proposed guidance, the notion of highly effective offset is critical to supporting a qualitative subsequent accounting methodology for hedges, and we believe that preparers will benefit from additional clarity regarding how to establish that highly effective offset exists.

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.

We believe that there are circumstances in which the indicators in ASC 815-20-35-2C signal that a qualitative assessment approach is no longer appropriate but that, upon performing a quantitative assessment, the hedge could be highly effective. In such circumstances, in order to return to an ongoing qualitative assessment approach, we believe it is necessary for an entity to demonstrate that that circumstances that led to its initial disqualification from a qualitative assessment approach are not expected to recur in the foreseeable future, and that the hedging relationship is expected to be highly effective in subsequent periods. We believe this approach would apply to situations where an anomalous event or change in circumstances has occurred.

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.

We agree, although we believe that in addition to allowing entities until the next quarterly effectiveness testing date to perform the initial quantitative test, entities should be permitted to document the method for retrospectively and prospectively assessing effectiveness any time between the hedge inception date and the first quarterly effectiveness testing date. We believe this would allow an entity that initially intended to apply the shortcut or critical terms match method, but subsequently, and before the first quarterly effectiveness testing date, determined that it is ineligible for either of those methods, to achieve hedge accounting by applying a long haul method.

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.

We have observed that some private companies fail to qualify for hedge accounting because they are not aware that their hedge documentation is deficient until it is reviewed by their external auditor in connection with a year-end audit. If the Board endeavors to provide additional documentation relief to private companies, then we believe the Board should consider allowing private companies to defer preparation of initial hedge documentation until the date the financial statements are available for issuance.

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

We believe that the effective date for entities other than public business entities should be deferred by one year relative to public business entities, with an option for entities other than public business entities to adopt the guidance at the same time as public business entities.

Question 14: Do you agree with the proposed transition method and disclosures in paragraph 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.

We agree with the proposed transition method, transition disclosures, and the Board's decision not to allow retrospective transition.

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We would be pleased to discuss our comments with you. If you have any questions, please contact Mark Scoles at 312.602.8780 or mark.scoles@us.gt.com.

Sincerely,

/s/ Grant Thornton LLP