November 4, 2016

Ms. Susan Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: File Reference No. 2016-310

Dear Ms. Cosper:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the FASB's proposed Accounting Standards Update, *Derivatives and Hedging* (Topic 815) (the "Exposure Draft").

We are supportive of the Board's overall objective in this project of better aligning the hedge accounting guidance with reporting entities' risk management strategies. We agree with the majority of the Board's decisions in the proposed amendments and have some suggestions on how some of the proposals could be enhanced. Some of the proposals, however, are, in our view, inconsistent with the board's objective and/or create additional inconsistencies and complexities in an already complex model. A summary of the proposals that we support and those that we do not support are provided below. The Appendix to this letter contains responses to the detailed questions for respondents and further rationale for our views.

We support the following proposed amendments:

- Hedging contractually specified components in nonfinancial items - We believe that this proposed amendment will more closely align the hedge accounting model with an entity's risk management objectives. However, we recommend that the Board consider whether hedging a component of a nonfinancial item can be expanded beyond those components that are contractually specified. In our experience, in certain industries where the risk can be clearly identified, common practice is not to contractually specify those components.

- Benchmark interest rate concept - We agree with the Board's decision to retain the concept of benchmark interest rates for fair value hedges of fixed-rate instruments and cash flow hedges of forecasted issuances or purchases of fixed-rate financial instruments. In both of those cases, an entity is attempting to hedge an isolated component of the overall variability in fair value or cash flows (interest rate risk) by inferring a "benchmark" interest rate embedded in the overall fixed contractual coupon. Because the benchmark rate is not contractually specified, we believe the final standard should contain guidance on how to isolate and identify that risk. In that regard, we note that the existing benchmark interest rate guidance in ASC 815-20 has been an effective tool for these types of exposures.

- Contractual coupon vs. benchmark rate component - We agree with the Board's decision for fair value hedges of interest rate risk to allow, in certain circumstances, the measurement of the change in value of the hedged item to be based on the benchmark rate component of the contractual coupon cash flows. In those circumstances, the calculation of the change in value of the hedged item attributable to changes in the benchmark interest rate would no longer incorporate the change in present value of the spread above the benchmark interest rate inherent in the contractual coupon. We view this as an improvement to the current benchmark interest rate hedging model for fair value hedges as it more closely aligns the mechanics of hedge accounting

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with the risk being hedged. We also agree that, in some circumstances, using only the benchmark rate component to measure the change in fair value of the hedged item may not be appropriate. However, we recommend that the criterion necessary to qualify for use of the benchmark rate component of the contractual cash flows be that the contractual coupon is greater than the benchmark rate at hedge inception.

- Presentation of amounts included in the assessment of effectiveness - We view the proposed requirement to present the entire change in fair value of the hedging instrument included in the assessment of effectiveness in the same income statement line item in which the earnings effect of the hedged item is presented as part of a "package" along with the Board's decision to no longer separately measure and record hedge ineffectiveness. That is, we believe it is a natural consequence of the Board's decision to no longer separately measure and record hedge ineffectiveness. We also view that decision as a significant simplification relative to the existing model that will make the reporting for hedging activities easier for users of financial statements to understand. As a result, we agree with this proposal in the context of that broader decision.

- Revised income statement table disclosure and the requirement to disclose the cumulative basis adjustment of the hedged item in a fair value hedge - Most of the information needed to compile the proposed income statement table disclosure is already required by existing guidance, and we believe the proposed format will enhance users' ability to see the impact of hedging on the individual line items in the income statement. We also believe the proposed disclosure of cumulative basis adjustments is useful to better understand the future obligations of an issuer when the carrying amount of the hedged item has been adjusted as a result of applying fair value hedge accounting.

- Subsequent qualitative effectiveness assessments - Many hedge relationships are highly effective at hedge inception and throughout the life of the hedge relationship. In many instances, companies know their hedges continue to be highly effective and the results of running complex calculations simply confirm this. As a result, in many instances, these ongoing calculations create incremental cost with no corresponding benefit to the financial statements. This proposed change will also ease the operational burden of administering and maintaining a hedge accounting program for those reporting entities that choose to apply the proposed change.

We do not support the following proposed amendments:

- Income statement presentation of amounts excluded from the assessment of effectiveness and amounts reclassified from AOCI related to forecasted transactions that are probable of not occurring - The amounts excluded from the assessment of effectiveness are not considered to be part of the hedge accounting relationship. We believe the gains/losses on those excluded amounts should be treated in the same manner as the gains/losses on any other non-designated derivative (i.e., fair value through income with no prescribed income statement presentation guidance, along with disclosure). Regarding the amounts reclassified from AOCI related to forecasted transactions that are probable of not occurring, we believe that recording these reclassifications in the same line item in which the hedged transaction would have been presented had the hedged transaction occurred could potentially be misleading. For example, a hedge of forecasted foreign currency sales when the derivative is out of the money would be reported as negative revenue even when the counterparty to the derivative is not a customer and there was, by definition, no corresponding revenue transaction.

- <u>Disclosure of quantitative hedge accounting goals</u> - The objective of this requirement is unclear. It focuses only on hedge accounting as opposed to an entity's overall risk management strategy. As a result, it may actually be misleading without the broader context of the entity's overall hedging strategies.

- <u>Inability to return to a qualitative effectiveness assessment once a quantitative assessment is performed in a period subsequent to hedge inception</u> - Circumstances may exist in which an entity may believe a quantitative reassessment is appropriate even when a specific event does not trigger the need for such an assessment. In cases when the quantitative assessment continues to support that the hedge is highly effective, we do not believe an entity should be precluded from returning to a qualitative assessment. Such a prohibition would likely discourage entities from performing a quantitative assessment, which is not in the best interests of users. In addition, we do not believe that a reporting entity should be effectively penalized for electing to perform a more rigorous quantitative analysis from time to time.

In addition to our responses to the specific questions and additional discussion of our observations above, the Appendix contains several questions on the interaction of proposed guidance with existing guidance (refer to the "Other Comments" section of the Appendix).

* * * * *

If you have any questions regarding our comments, please contact Patrick Durbin at (973) 236-5152, John Althoff at (973) 236-7021, or Chip Currie at (973) 236-5331.

Very truly yours,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP

Appendix

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 believe that, relative to the current guidance in this area, the proposed amendment will more closely align the application of hedge accounting (as well as the reported results) with an entity's risk management objectives.

Many entities are exposed to the variability in the price of forecasted purchases and sales of nonfinancial assets. In many instances, the market price of a nonfinancial asset is heavily influenced by specific components, such as a commodity that is utilized in the production of the asset. As part of prudent risk management strategies, entities seek to hedge these components utilizing derivative contracts. As a result of the current requirement to hedge the total price risk of a nonfinancial item that contains a commodity component, many entities are unable to qualify for cash flow hedge accounting. The consequence of the current model for those entities is that they either continue to bear commodity price risk (even if prudent risk management would dictate otherwise) or mark their derivatives to market through earnings (and live with the associated earnings volatility).

The proposed amendment will result in a more accurate portrayal of an entity's risk management strategies in the financial statements as more hedges of nonfinancial items (including more portfolios of nonfinancial items) will qualify for hedge accounting. In addition, the reported results of those hedges will more closely reflect the entity's actual risk management strategy to hedge a component of the all-in price.

Although we are supportive of the proposed amendment, which we view as a positive step forward relative to the current guidance in this area, we believe that the Board should consider whether the ability to hedge a component of a nonfinancial item can be expanded beyond those components that are contractually specified. For example, in certain commodities markets there are components that are not contractually specified in purchase/sale agreements but for which it is the market convention to use the component as an underlying basis for determining the price of the overall product. Limiting the designated hedged item in a nonfinancial instrument to only contractually specified components is form-driven and would omit certain hedging strategies for components that, economically and from a risk management perspective, are managed similar to contractually specified components. Therefore, such a limitation may not align the application of hedge accounting (or the reported results) with an entity's risk management objectives. While we believe that further consideration should be given to expanding the ability to hedge nonfinancial components beyond those that are contractually specified, we would not want the Board's deliberations on this topic to delay the issuance of the final standard.

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 concept of benchmark interest rates for fair value hedges of fixed-rate instruments and cash flow hedges of forecasted issuances or purchases of fixed rate financial instruments. In both of those cases, an entity is attempting to hedge an isolated component of the overall variability in fair value or cash flows (interest rate risk) by inferring a "benchmark" interest rate embedded in the overall fixed contractual coupon. Therefore, it is important to provide guidance on how to isolate that risk. The benchmark interest rate guidance has been an effective tool under the current guidance for these types of exposures.

We understand that in the US, entities look to the explicit list of acceptable benchmark interest rates (as opposed to the broader principle). However, for US entities with operations abroad or foreign entities that report under US GAAP, the broader concept of a benchmark interest rate remains relevant as there is no comparable list of non-US benchmark interest rates, and it is not practical to provide one. As a result, the Board should consider providing additional guidance for determining benchmark interest rates in foreign jurisdictions. For example, providing guidance that an entity may consider whether a local interest rate has similar characteristics to the US benchmark interest rates when determining whether such local rate would qualify as a benchmark interest rate may be helpful and would codify current practice.

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?*

We do not believe the Board should consider expectations that a rate *will become* widely used in the concept of benchmark interest rates. Rates that would qualify as a benchmark rate do not arise frequently, therefore the standard-setting burden to address individual rates as they come up and add them to the list of benchmark interest rates does not seem that significant. In addition, including expectations that a rate will become widely used could lead to diversity in practice (e.g., some may believe a rate will become widely used while others may not) and other practical issues (e.g., how to handle situations when a rate was expected to become widely used but ultimately does not).

If the Board decides to consider an expectation that a rate will become widely used in the benchmark interest rate concept, we believe a well-defined framework should be provided to mitigate diversity in application.

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 rates that should be added to the list.

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 are not currently aware of other alternatives to the current concept of benchmark interest rates that would provide significant incremental practical benefits to what the Board has proposed in the exposure draft.

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 the Board's decision to allow, in certain circumstances, the measurement of the change in value of the hedged item in a fair value hedge of interest rate risk to be based on the benchmark rate component of the contractual coupon cash flows. In those circumstances, the calculation of the change in value of the hedged item attributable to changes in the benchmark interest rate would no longer incorporate the change in present value of the spread above the benchmark interest rate inherent in the contractual coupon. We view this as an improvement to the current benchmark interest rate hedging model for fair value hedges.

We also agree that there are certain circumstances when it may not be appropriate to measure the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon. We understand the Board's considerations outlined in BC119 and BC120, and understand that the proposed requirement for the market yield to be greater than the benchmark rate component at hedge inception is designed to accomplish the Board's objective of allowing fair value hedging to be applied to "late-term hedges" under both the long haul and shortcut methods. The Board's proposal could result in situations when the cash flows used to model the changes in fair value of the hedged item are greater than the contractual cash flows of the hedged item. In these cases, the calculation of changes in fair value of the hedged item would include cash flows that do not exist in the hedged item. This will have the impact of creating additional interest rate exposure on the hedged item that does not exist. Therefore, we recommend that the qualifying criteria for an entity to be able to use the benchmark rate component of the contractual cash flows be that the contractual coupon cash flows are greater than the benchmark rate at hedge inception. We note that several other of the Board's proposed changes will be effective at reducing some of the operational difficulties in applying hedge accounting to "late-term hedges."

If the Board does not agree with our recommendation and believes that more easily allowing hedge accounting for "late-term hedges" is critical to the project, we believe the Board can still accomplish its objective by simply stating that entities are allowed to use the benchmark rate component, without including any qualifiers.

In addition, we suggest that the Board consider clarifying the concept of the benchmark rate component in circumstances when the debt being hedged is callable. For example, the benchmark interest rate of a 10-year debt instrument that is callable at par plus accrued interest at the end of year 7 is not clear. We believe a possible solution could be the fixed rate of a 10-year swap with an initial fair value of zero that is cancelable at the end of year 7.

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?*

We do not believe there is a "bright line" as to what constitutes a "pattern" of determining that the hedged forecasted transactions are probable of not occurring. There are many assumptions and variables associated with the probability of occurrence of a forecasted transaction that are difficult to assimilate into a one-size-fits-all policy.

When forecasted transactions become probable of not occurring, we believe that the reasons for the missed forecasted transaction should be analyzed. We believe it is important to understand the root cause for the missed forecast, e.g., was it related to estimation uncertainty, unforeseen or unforeseeable conditions/events, changes to systems/processes/people, or other factors? Once these factors are identified, their impact on future forecasts should be considered. In particular, we believe whether the root cause is expected to have an impact on the entity's ability to accurately forecast in the future is an important consideration. We believe it is important to understand whether there is a systemic/fundamental issue with a company's ability to forecast that could impact future cash flow hedges, or whether the missed forecast was the result of a more narrow or one-off issue.

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 there are many hedge relationships that would qualify for hedge accounting under both the FASB's proposed amendments and IFRS 9. However, there are several fundamental differences that could result in recognition and presentation differences related to hedge accounting results, including:

- Under IFRS 9, hedge ineffectiveness is still required to be measured and recorded in current period earnings, while the FASB's proposal has eliminated the concept of hedge ineffectiveness. For hedges that have some level of ineffectiveness, this could result in recognition and presentation differences. For example, in a qualifying cash flow hedge, any hedge ineffectiveness is recognized in current earnings under IFRS 9, but under the FASB's proposal, the cumulative ineffectiveness would be reported in a later period when the hedged item impacts earnings.

- The proposed amendments specify that the entire change in value of the hedging instrument included in the assessment of effectiveness be presented in the same income statement line item as the hedged item, while IFRS 9 does not prescribe the income statement presentation.

- Under IFRS 9, for a cash flow hedge of a forecasted purchase of certain nonfinancial items, the effective portion of the change in value of the hedging instrument is presented as a basis adjustment to the asset when purchased. The FASB's proposal does not permit this presentation, and as a result, the cumulative change in fair value of the hedging instrument will be reported in accumulated other comprehensive income until the hedged item impacts earnings.

- In certain hedge relationships, there will be differences between IFRS 9 and the FASB's proposal related to the recognition of time value in an option, spot-forward differences in a forward, and cross currency basis spreads.

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.*

We view the proposed requirement as part of a "package" with the Board's decision to no longer separately measure and record hedge ineffectiveness. That is, a natural consequence of the Board's decision to no longer separately measure and record hedge ineffectiveness was that the entire change in value of the hedging instrument included in the assessment of effectiveness would be presented in a single line item along with the hedged item. We also view the Board's decision to no longer separately measure and record hedge ineffectiveness as a significant simplification relative to the existing model that will be easier for users of financial statements to understand. As a result, we agree with this proposal in the context of that broader decision package.

Historically, the Board has not provided prescriptive guidance on the income statement presentation related to hedge accounting. Given that the Board has now proposed prescriptive income statement guidance, we recommend that the Board consider exploring whether it should also provide prescriptive guidance related to the presentation of the effects of hedge accounting on the statement of cash flows.

We also note that while the exposure draft would require the change in value of the hedging instrument to be included in the income statement line item in which the earnings effect of the hedged item is presented, ASC 606, *Revenue from Contracts with Customers*, scopes out instruments that are within the scope of ASC 815. A common hedge accounting strategy is for an entity to use foreign currency derivatives to hedge forecasted foreign currency-denominated revenue. We are unclear as to the interaction between the proposal (which, in this example, would require the derivative gain/loss to be included in revenue) and the guidance in ASC 606 (which explicitly scopes out derivative contracts). We recommend that the Board clarify the interaction between the proposed guidance and ASC 606 with respect to the income statement presentation of gains/losses on derivatives designated in hedge accounting relationships.

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.*

We disagree with the proposed presentation guidance related to excluded components. We note that the Board's proposal is to report the entire change in value of the hedging instrument included in the assessment of hedge effectiveness in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. However, the guidance (existing and proposed) allows certain amounts to be excluded from the assessment of effectiveness. Those excluded amounts are therefore not considered to be part of the hedge accounting relationship. We believe the gain/loss on those excluded amounts should be treated in the same manner as the gain/loss on any other non-designated derivative (i.e., fair value through income with no prescribed income statement presentation guidance, along with disclosure).

In addition, we believe that prescribing that the change in value of the excluded amounts be presented in current earnings in the same line item as the hedged item is potentially confusing to users of financial statements because the timing of recognition of the excluded components through earnings will differ from the timing of when the hedged item affects earnings. For example, assume an entity has designated a cash flow hedge of a forecasted purchase of inventory; further, assume the entity purchased the hedged inventory in Year 1 and sold it in Year 2. Any excluded components would be recorded in Year 1 as part of cost of goods sold while the sale of the actual inventory being hedged would be recognized in Year 2.

We note that there are different ways in GAAP (existing and proposed) in which only components of a derivative are designated in a hedge accounting relationship. One way this can occur is excluding certain components (e.g., the change in time value, or change in value related to changes in the difference between spot and forward prices). However, another is to only designate a percentage of an entire derivative as the hedging instrument, with the remaining percentage excluded from the hedge accounting relationship. For example, an entity may decide to only designate 90% of a derivative into a hedge accounting relationship, with the remaining 10% excluded from the hedge accounting relationship. We understand that excluded amounts, such as time value and spot-forward differences, would be required to follow the prescriptive income statement presentation guidance. However, it is not clear to us what the FASB's intent was regarding the situation when a percentage of an entire derivative is excluded from a hedge accounting relationship. We recommend that the FASB clarify this point.

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

We disagree with the proposed presentation guidance for reclassified amounts related to forecasted transactions that are probable of not occurring. We believe it would be more appropriate to present these types of reclassifications in a manner similar to how the gain/loss on any other non-designated derivative would be presented (i.e., fair value through income with no prescribed income statement presentation guidance, along with disclosure).

Similar to our response to question 6(b) above, we have the same concerns that recording these reclassifications in the same line item that the hedged transaction would have been presented had the hedged forecasted transaction occurred could potentially make that line item misleading. For example, a US company with only domestic operations may have a one-off transaction in which they will have a foreign currency-denominated forecasted sale. Given the foreign currency risk inherent in the transaction, the company may decide to enter into a cash flow hedge using a foreign currency derivative. If at a later date it becomes clear that the forecasted transaction is not going to occur, the company would be required to show the cumulative impact of the changes in fair value of a foreign exchange derivative in sales revenue when that line item has no foreign currency elements related to revenue.

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*

We believe this is useful information as it enables a user to better understand the future obligations of an issuer when the carrying amount of the hedged item has been adjusted as a result of applying fair value hedge accounting. We note that certain reporting entities are currently disclosing these amounts. Including a requirement to disclose these amounts will ensure consistency in disclosure related to these types of hedge relationships.

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*

We do not agree with this proposed amendment.

Regarding an entity's objectives, there are existing requirements for qualitative disclosures about an entity's hedging objectives and strategies for using derivative instruments, including the volume of derivative activity. In addition, ASC 815-10-50-5 states that these qualitative disclosures "may be more meaningful if such objectives and strategies are described in the context of an entity's overall risk exposures," and that, if made, "should include a discussion of those exposures even though the entity does not manage some of the exposures by using derivative instruments."

It is unclear how companies would apply the proposed disclosure principle in practice, as the proposed requirement to disclose "goals" only relates to the application of hedge accounting, as opposed to an entity's overall risk management strategy. As a result, it may not provide users with an understanding of the effectiveness of the entity's overall hedging strategies, and may actually be misleading. A very common hedge strategy is for an entity to take advantage of natural offsets and enter into hedging positions based on a net open position. Since the hedge accounting rules effectively prohibit hedging a portfolio of offsetting or dissimilar risks, hedge accounting is often documented as hedging a portion of one of the "gross" positions. For example, assume a USD reporting entity has EUR 80 of forecasted expenses and EUR 100 of forecasted sales to occur in the same month. From a risk management standpoint, the entity wants to hedge the net position, but the hedged item designated for hedge accounting purposes must be a gross position. So in this example, the company would hedge EUR 20 of forecasted revenue.

If the proposed disclosure focuses solely on hedge accounting goals and defines those based on the hedge accounting documentation, the company in our example would disclose that its goal is to apply hedge accounting to 20% of its forecasted EUR revenue, which would not be an accurate portrayal of the entity's actual risk management objective. Given the difficulties in providing a holistic discussion of an entity's risk management strategies through the hedge accounting results, we believe that such a holistic discussion may be better suited for disclosure in Management's Discussion and Analysis.

Regarding an entity's success in achieving its quantitative hedge accounting goals, we are concerned that the proposed disclosure will introduce complexity in interpreting whether hedging goals were actually met. For example, assume an entity has a goal to apply hedge accounting to 80% of its commodity purchases, and the entity had forecasted that it was going to purchase 100 units of the commodity during the year. Therefore, the entity executed a derivative instrument with a notional amount of 80 units. At the end of the year, the entity may realize that actual purchases were higher (resulting in hedging only 70% of the actual purchases), or lower (resulting in hedging 90% of the actual purchases). Would the entity disclose that the hedge accounting program was unsuccessful in those circumstances? Hedging goals established by many organizations can be complex and iterative (e.g., layering strategies in which different percentages of forecasts are hedged depending on the timing of those forecasts). In addition, as discussed above, hedging goals may change as the result of changing circumstances, including transactions unrelated to the hedged item that change the net open risk position. As a result, making an objective statement regarding whether the entity was successful in achieving its hedge accounting goals could be very challenging.

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 the proposed amendment. The predominance of the information needed to compile this disclosure is already required by existing guidance. We believe the proposed format is an enhancement as it will allow users to see the impact of hedging on the individual line items in the income statement.

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 the proposed change. There are many hedge relationships that are highly effective at hedge inception and continue to maintain this level of effectiveness throughout the life of the hedge relationship. In many instances, companies know their hedges continue to be highly effective and the results of running complex calculations simply confirm this. As a result, in many instances, these ongoing calculations create incremental cost with no corresponding benefit to the financial statements. Relative to the existing guidance, this proposed change will contribute to easing the operational burden of administering and maintaining a hedge accounting program for those reporting entities that choose to apply the proposed change.

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 there can be circumstances in which an entity may no longer feel comfortable asserting qualitatively that the hedging relationship continues to be highly effective, but when tested quantitatively would be highly effective. In addition, we believe that, in certain circumstances, a reporting entity should be allowed to return to a qualitative assessment once it proves quantitatively that the hedge relationship is still highly effective.

One very common type of hedge relationship is a cash flow hedge of a forecasted issuance of debt. Oftentimes, the expected date of the debt issuance changes subsequent to hedge inception. In that situation, the entity may feel that it should run a quantitative assessment to ensure that the hedge remains highly effective given the new best estimate of the debt issuance date. The results of that quantitative assessment may indicate that there has not been a meaningful impact to the effectiveness of the hedge relationship. Another example could be a hedge of a pegged currency where the currency peg is removed. In this case, an entity may feel that it should run a quantitative assessment for several periods to ensure that the hedge remains highly effective given the change in the hedge relationship. The results of those quantitative assessments may indicate that there has not been a meaningful impact to the effectiveness of the hedge relationship. These are examples of when there were changes that impacted the effectiveness of the hedge relationship, but the results of the quantitative assessment proved that the fundamental relationship between the hedging instrument and hedged item/transaction remained, so there was nothing to invalidate the use of qualitative assessments in future periods.

We also note that precluding entities from returning to a qualitative assessment once a quantitative assessment is run could have the effect of dissuading entities from checking their qualitative assessment by running the quantitative assessment. We do not believe that a reporting entity should be precluded from returning to a qualitative test when it performs a more rigorous quantitative analysis to confirm the validity of its qualitative assessment.

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 with the proposed amendment to allow an entity to perform the initial quantitative assessment at any time between hedge inception and the quarterly effectiveness testing date. The proposed amendment would provide administrative relief regarding the timing of performing the initial quantitative assessment. We note that this amendment would have no impact on the quality of financial reporting because if such an assessment, performed using market data as of the hedge designation date, fails, there would not have been reported financial results reflecting the derivative in a hedging relationship.

We note that the proposal still requires an entity to document the method of performing the quantitative effectiveness assessment at the time of hedge designation (along with all other hedge documentation requirements). The manner in which an entity documents its quantitative effectiveness assessment methodology in its hedge documentation is sometimes finalized through an iterative process in connection with actually performing the initial quantitative assessment. As a result, some may view the requirement to document the quantitative effectiveness assessment methodology at hedge inception as limiting the relief that was intended by the Board's proposal.

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 do not believe that extra time should be afforded to private companies and do not believe that the content of the hedge documentation should differ. Certain private companies are already afforded extra time to complete hedge documentation under the "simplified hedge accounting approach" for certain cash flows hedges.

In addition, we believe the content that is required in the hedge documentation at the hedge designation date is necessary to maintain the discipline around the designation of a hedge accounting relationship. Contemporaneous documentation of a hedge is critical because without it, an entity could retroactively identify a hedging instrument, hedged item, or a hedged transaction to achieve a desired accounting result. This is relevant to all companies, and therefore we do not believe that there should be any differences in the content of the hedge documentation between public and private companies.

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

We support a one-year delay in the effective date for entities other than public business entities, consistent with the issuance of other recent standards. We believe that early adoption should be permitted for all entities.

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

We believe that questions regarding the time period required for implementation are better addressed by preparers.

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 Board's proposed transition approach and one-time transition options. However, we note that for certain types of hedging instruments (e.g., foreign exchange or commodity forward contracts) designated in cash flow hedge relationships, there may be a double counting of "ineffectiveness" in earnings. Prior period financial statements will include hedge ineffectiveness in the income statement. Upon adoption, any cumulative historical ineffectiveness on existing hedges will be re-established in AOCI as part of the transition provisions and the comparative periods will not be restated. That ineffectiveness will be presented in the income statement a second time when the forecasted transaction impacts earnings. In addition, the ineffectiveness recorded in historical periods may be reported in different line items than the reporting of this ineffectiveness for a second time in a future period after considering the proposed guidance relating to income statement geography. We recommend that the Board consider allowing a retrospective transition approach for cash flow hedge relationships to address this issue.

Other Comments

Hedging nonfinancial contractually specified components in a not-yet-existing contract

The proposed standard will permit the hedging of contractually-specified components of forecasted purchases and/or sales of nonfinancial assets. The proposed guidance will permit hedges of purchase and sales forecasted to occur under existing contracts, as well as under future contracts that have not been executed but are forecasted to be executed. We are supportive of these concepts. However, we have some comments on the proposed guidance and how it interacts with other guidance in the standard.

Topic 1

We are unclear on the application of the guidance to a hedge accounting relationship where forecasted purchases and sales, that were anticipated to be executed under a contract that did not exist as of the hedge designation date, ultimately occur without having a contractually specified component. For example, assume an entity forecasts purchasing a part when the purchase price of that part will have a contractually specified commodity component. Prior to purchasing the part, the entity changes its forecast whereby it will still purchase the part as anticipated, but the contract to purchase it does not contain a contractually-specified component. It is unclear to us how the guidance in paragraphs 815-20-55-26A through 55-26C of the exposure draft (in particular, paragraph 815-20-55-26B) interacts with the guidance in paragraph 815-20-25-3(d)(vi), which states, in part, "The hedged forecasted transaction shall be described with sufficient specificity so that when a transaction occurs, it is clear whether that transaction is or is not the hedged transaction."

A common hedge strategy is for an entity to hedge the "first" X units of a particular nonfinancial asset purchased in a given month, when there may be a series of purchases of that nonfinancial asset in the month. For example, assume that an entity designated that it was hedging the variability in cash flows related to a contractually specified component of the first 100 units of a nonfinancial asset to be purchased in November 20X7, and that the entity forecasted a series of separate purchases of the commodity in November 20X7. During the month of November 20X7, the entity expected to purchase the same nonfinancial asset under contracts both with and without contractually specified components. The entity designed its hedge designation of the contractually specified component to achieve higher hedge effectiveness than would have been achieved if they were hedging forecasted purchases without contractually specified components.

If none of the entity's purchases of the commodity in November 20X7 have a contractually specified component, how would the entity know which purchase was being hedged at the time the purchase occurred, as required by paragraph 815-20-25-3(d)(vi)? It would appear that, in this fact pattern, the entity would not know until the end of November 20X7 that it did not have a purchase with a contractually specified component and thus at that point would identify purchases that already occurred under a contract without contractually specified components as the hedged items. We recommend that the Board clarify the interaction between paragraphs 815-20-55-26A through 55-26C of the exposure draft and the existing guidance in paragraph 815-20-25-3(d)(vi).

Topic 2

Paragraph 815-20-55-26B indicates that, given the fact pattern in that example, Entity A should discontinue hedge accounting because the designated hedged risk is not present in the executed contract. Generally, an entity would be required to prove that the hedge accounting relationship was highly effective through the date of de-designation (that is, a final assessment of effectiveness would be performed immediately prior to de-designation). We are unclear as to what Entity A would be required to do upon de-designation in this example. Would Entity A be required to perform a final assessment of effectiveness? If so, what assumptions would be used when, for example, constructing the hypothetical derivative to perform that final assessment? We recommend that the Board clarify paragraph 815-20-55-26B by providing guidance on what, if any, effectiveness assessment requirements Entity A would have upon a de-designation due to a contractually specified component ultimately not existing in its executed contract.

Topic 3

Paragraph 815-20-55-26A of the exposure draft indicates that Entity A "expects" to have a forecasted transaction in which the purchase price will contain a contractually specified component. However, there does not appear to be a requirement for Entity A to assert that it is "probable" that there will be a contractually specified component in the not-yet-existing contract. The introduction of the term "expects" into the proposed guidance raises questions as to what level of certainty would be required in order to utilize a contractually specified component strategy. We recommend that the Board provide clarity on the term "expects" similar to the guidance provided in Topic 815 on the term "probable".

When the contract in the example is executed and does not contain the contractually specified component that Entity A expected, paragraph 815-20-55-26B of the exposure draft indicates that the outcome is to simply de-designate the hedge. It is unclear to us what, if any, implications this would have on similar future hedge relationships for Entity A. We recommend that the Board clarify how, if at all, a pattern of "expecting" contractually specified components in a not-yet-existing contract that do not ultimately materialize would impact future similar hedges for that entity.

Topic 4

Paragraph 815-20-55-26A of the exposure draft makes several references to both existing and not-yet-existing contracts between Entity A and Supplier Z, specifically. One could read this example to imply that Entity A is only permitted to hedge a contractually specified component in a not-yet-existing contract if it has an existing contract with that same supplier. We do not believe the standard should limit the ability to hedge a contractually specified component in a not-yet-existing contract in that manner. If this was not an intended outcome, we recommend that the Board clarify that an entity does not need to have an existing contract with a supplier in order to hedge a contractually specified component in a not-yet-existing contract. Additionally, if there are existing contracts with multiple suppliers and not-yet-existing contracts with multiple suppliers (some of whom may not be part of the existing supplier group), we believe the expected contractually specified components in the not-yet-existing contracts with any of the suppliers should be eligible to be the hedged transaction.

Forecasted issuance/purchase of debt

The proposed guidance related to interest rate risk hedges of forecasted debt issuances/purchases indicates:

- If an entity knows it will issue/purchase fixed rate debt, it should follow the benchmark interest rate model
- If the entity knows it will issue/purchase variable rate debt, it should follow the contractually specified interest rate model

- If the entity is unsure whether it will issue/purchase fixed or variable rate debt, it should designate an interest rate that would qualify as both a benchmark rate and a contractually specified rate

Assume that an entity is unsure whether it will issue fixed or variable rate debt, but wishes to hedge the interest rate risk associated with the forecasted issuance of debt. Based on the guidance in the proposed exposure draft, the entity chooses LIBOR as its hedged rate (LIBOR would qualify as both a benchmark rate and a contractually specified rate), as they are unsure as to whether they will issue fixed or floating rate debt. However, when the entity ultimately issues the debt, it is variable rate debt based on an index other than LIBOR. Similar to our commentary related to several of the issues noted above in the "Hedging nonfinancial contractually specified components in a not-yet-existing contract" section above, it is unclear how the entity should apply the collective guidance in ASC 815. For example, is the entity required to do a final assessment of effectiveness? What is the impact to gains/losses deferred in other comprehensive income and would there be any potential implications for future similar hedging relationships? We recommend that the Board clarify these points.

Critical terms match - 31 day period

The exposure draft proposes that, in a cash flow hedge of a group of forecasted transactions, an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity of the hedging instrument match in accordance with paragraph 815-20-25-84(a) if those forecasted transactions occur within the same 31-day period as the maturity of the derivative. This proposed amendment is located in the critical terms match area of the guidance. However, it does not appear that similar 31-day relief was provided for options being used as hedging instruments under paragraph 815-20-25-129 (formerly, part of DIG Issue G20). We believe that the same guidance should be provided for options used in hedging relationships.

Deletion of illustrative guidance

In the proposed amendments, paragraphs 815-20-55-46 through 55-47 have been deleted. The deleted example illustrates that (a) the forecasted cash flows arising from a mixed attribute contract that meets the definition of a derivative are eligible to be hedged, and (b) the mixed attribute contract itself (which is a derivative) can be used in combination with another derivative and designated as a hedge of those forecasted cash flows. We believe this remains relevant guidance and recommend that it be updated by the Board to reflect the proposed amendments related to contractually specified component hedging.