Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

November 11, 2016
Via email to director@fasb.org

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

File Reference No. 2016-310

Re: Targeted Improvements to Accounting for Hedging Activities (File Reference No. 2016-310)

Dear Ms. Cosper:

We are pleased to offer comments on the Board's proposal to make targeted improvements to hedge accounting. We applaud the Board's objectives of simplifying the accounting and application guidance for hedging activities, which is often restrictive and complex. We believe that the proposal alleviates many of the concerns regarding the current guidance being difficult to understand and burdensome to apply. It also better reflects the risk management strategy that entities pursue for entering into hedges. Considering that the current guidance has been applied for more than a decade, we generally also agree that making targeted amendments is an efficient and effective manner to simplify the guidance. However, if the strict eligibility criteria for applying a qualitative method at hedge inception and the timing of preparing hedge documentation could be further eased, the proposals could be utilized by a wider range of entities that have differing levels of systems, personnel and processes.

Our responses to specific questions, including incremental suggestions and clarifications to make the proposals more operational by all entities, are provided in the Appendix to this letter. While we appreciate the Board's decision to address only targeted topics, we believe that unless related practice matters are also addressed, some of the benefits of the proposal may be reduced.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Gautam Goswami at (312) 616-4631 or Adam Brown at (214) 665-0673.

Very truly yours,

BDO USA, LLP

BDO USA, LLP

BDO USA, LLP, a Delaware limited liability partnership, is the U.S. member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO Member Firms.

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 agree with the Board's decisions and the basis for conclusions in this regard. However, we suggest that the Board monitor implementation issues with the "separately identifiable and reliably measurable" approach in IFRS to determine whether that more principles based approach can be incorporated in US GAAP at a later date. Considering that sometimes it is difficult to amend existing contracts, we also would not object in case that component is stated in any other objectively verifiable and available document, not necessarily the Company's final contract. For instance, if the component is specified in a pre-contract document that may not be *explicitly* referred to in the final agreement or in some other supplier provided material. We note that the proposal defines a contractually specified component as "An index or price explicitly referenced in an agreement to purchase or sell a nonfinancial asset other than an index or price calculated or measured solely by reference to an entity's own operations." While we note that what constitutes an agreement is not further expressed, the use of the term "contractually specified" in the guidance may lead to an interpretation that it necessarily has to be specified in the final agreement, a contract being an agreement enforceable by law. Therefore, even though paragraph BC 51 of the basis for conclusions indicates that the Board decided it was unnecessary to provide additional guidance on the legal nature of a contract that contains a contractually specified component, we believe a further clarification in this regard, as above, would make the guidance more operable. Perhaps, adding the phrase "or related documents" in the definition would still achieve the Board's objective while providing more latitude. E.g., "An index or price explicitly referenced in an agreement *or related documents* to purchase or sell a nonfinancial asset other than an index or price calculated or measured solely by reference to an entity's own operations."

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.**
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?**
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.**

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 agree with the Board's decision and reasons for retaining the concept of benchmark interest rates for hedges of fixed-rate financial instruments. Considering that benchmark interest rates are not expected to arise or change frequently, we do not believe that the Board should consider within the concept forward-looking expectations that another rate will become widely used. If expectations are built into the concept, we observe that it may also include "negative" expectations that a current benchmark rate may cease to become widely used. Incorporating "positive" or "negative" expectations in the concept would give rise to application issues. Therefore, we believe that if another rate does become widely used, the Board could deliberate it at that time, as was done for the OIS rate and the proposal to include the SIFMA rate as a benchmark rate. The Board could also assess at that time whether a new benchmark is a replacement of any of the existing rates. We are not aware of any other rates that currently should be added to the list or alternatives to the concept that 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 the Board's decision and basis for conclusions in this regard.

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 believe this should be a facts and circumstances assessment, e.g., was the forecast missed due to an event beyond the Company's control? Judgment also may need to be applied if the forecast was missed due to a change of management and related capital expenditures policy or financing strategy that was not contemplated at hedge inception by previous management. Further, our experience has been that Companies are generally very cautious in this regard, considering the consequences noted in paragraph 815-30-40-5. To avoid triggering this clause, many entities take a "haircut" in hedging forecasted transactions e.g., if the forecast is for 100 units to be purchased, many companies will only hedge up to 75 units. However, in general, if it is determined that a "strike" has occurred, we are not aware of current practice allowing more than three strikes without calling into question management's assertions in this regard.

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

For qualifying hedges, we generally agree with the decision to present the effect of the hedge in the same income statement line item in which the earnings effect of the hedged item is presented. However, we disagree with the proposal for amounts excluded from the effectiveness assessments or related to transactions that are no longer probable of occurring. We believe those items are similar to non-designated or "economic" hedges, for which the Board has not provided any prescriptive presentation. Alternatively, if these items are to be presented in the same line as the hedged item, we believe that the cost of hedging model referred to in paragraph BC62 of the basis for conclusions also should apply to "economic" hedges.

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.**

Users and preparers will likely have meaningful insight on this question, including the cost-benefit considerations. However, we note that entities may employ "economic" hedges in addition to "accounting" hedges and their risk management strategy may primarily be based on first economically hedging an exposure and then determining on a case-by-case basis whether to apply hedge accounting, if eligible. Therefore, we question whether disclosing quantitative hedge accounting goals would be meaningful in that context. It is also unclear whether the "if any" qualifier means that an entity is exempt from this disclosure if it only has informal or unwritten quantitative goals or whether the absence of a quantitative hedge accounting goal needs to be disclosed. Further, if those goals are dynamic or, for instance, adjusted after period end but before the issuance of the financial statements, it is not clear what should be the extent and nature of the disclosures that would provide the user with meaningful information. As such, perhaps a more meaningful disclosure for the Company to consider would be in MD&A, which could

incorporate forward-looking expectations. For private companies, key stakeholders could separately request this information directly from management.

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 recommend an approach under which subsequent effectiveness assessments are required only if circumstances (i.e., a triggering event) indicate that the hedging relationship no longer may be highly effective, similar to what the Board considered in BC80. For example, a triggering event requiring reassessment could be a floor or cap that earlier had minimal value now being significant because of interest rate movements. While potential triggers would still need to be monitored, in our view, a trigger-based quantitative assessment would be beneficial for at least two reasons. First, a quantitative approach will provide conclusive evidence and therefore be a more efficient means of assessing effectiveness. Second, this will have the added benefit of minimizing the approach for second-guessing that would inevitably accompany an ongoing qualitative assessment. Consequently, we believe an approach of this nature would make the final amendments more operational than the proposal. It still would have to be verified each period that the critical terms have not changed, the hedged transaction is still probable of occurring and that no adverse changes in counterparty credit-risk have occurred.

However, if the proposal is finalized as it is, see our responses to Question 11 below regarding easing the requirements to apply a qualitative method, as that would simplify the application of the proposed guidance.

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.

If there are no changes to the circumstances that required quantitative testing or in critical terms, we would not object to returning to subsequent qualitative assessments, assuming the Board adopts a qualitative approach. That is, presuming that the events that triggered quantitative testing are expected to be infrequent, we do not believe that a requirement to perform a quantitative assessment should be irreversible, but should be permitted depending on facts and circumstances. Please see our response to Question 11 below regarding consideration of a qualitative assessment for hedging relationships that have key terms that nearly, but not exactly, match.

Further, considering that similar hedges should be assessed for effectiveness in a similar manner under 815-20-25-81 (and proposed paragraph 815-20-35-2B), we recommend clarifying whether all similar hedges would be required to apply a quantitative method if any one of them requires a quantitative assessment. Alternatively, would an isolated change in circumstances for one but not necessarily the other similar hedging relationships effectively mean that those hedges are no longer similar?

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 that an entity should be allowed to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date. However, we are unclear whether the phrase "quarterly effectiveness testing date" means the end of the fiscal quarter or whether the test can be performed any time up to the date that the quarterly financial statements are issued e.g., by a public company. We question whether it always is necessary to use data applicable as of hedge inception date for carrying out the initial quantitative test or whether a practicability accommodation can be provided if desired by some entities, for example those referred to in paragraph BC86 that prefer ongoing quantitative tests. Paragraph 815-20-25-79 requires hedge effectiveness to be assessed whenever financial statements or earnings are reported. Therefore, perhaps that end of period data can be used for the test if key terms have not changed since inception. In other words, a combined assessment for that quarter could be carried out instead of potentially i) one prospective assessment "during" the quarter and ii) another prospective and retrospective assessment "at the end" of the quarter. Utilizing such an end of period assessment may be less burdensome for entities that enter into multiple hedges during a quarter. It also is a revalidation of hedge effectiveness. That is, we observe that if the quarterly assessment utilizing end of quarter data does not indicate the hedge to have been highly effective retrospectively, it likely was also ineffective at hedge inception.[1] For entities that prefer to carry out post-hedge inception assessments qualitatively, we believe that carrying out a combined quantitative assessment for the first quarter should not affect an election to carry out subsequent assessments qualitatively.

We suggest that some relief also be provided for preparing the other required aspects of the documentation, for instance, allowing at least two weeks' time from hedge inception. While we appreciate that requiring concurrent documentation is considered a safeguard for obtaining special hedge accounting, we do not believe providing some administrative relief, e.g., at least two weeks' (and perhaps even a month or more, depending on stakeholders' feedback) would be viewed as abusive.

Further, since an objective of the proposal is to make it easier to qualify for and continue hedge accounting, we suggest that entities be allowed to change their method of assessing effectiveness any time before the first effectiveness test date. For instance, a decision to change to regression instead of a dollar-offset or qualitative method or vice versa. Similarly, in light of the basis for conclusions paragraph BC85 that indicates even if a qualitative assessment is elected, an occasional quantitative assessment in support of the qualitative assessment would not be precluded, the Board could consider whether it still is meaningful to retain the requirement in

[1] The reverse can also happen i.e., the hedge being ineffective at inception, but highly effective at quarter end. However, the related risk of inappropriately applying hedge accounting would only be for the initial quarter.

paragraph 815-20-35-19 to redesignate the hedge if an entity prospectively identifies an *improved* method for assessing hedge effectiveness. Presumably, the quantitative method would be considered an improved method to a qualitative assessment. Also, since it is only for validating the qualitative assessment and not necessarily because of a change in facts and circumstances, we are unsure whether (and why) that quantitative method needs to be the same one used for the initial assessment, which appears to be implied. In other words, if the initial assessment was carried out applying regression, can the entity utilize a simpler dollar-offset method for carrying out the occasional quantitative assessment in support of the qualitative assessment? Further, we are unclear how the reference in paragraph BC85 to a third party is to be interpreted or why it is required. For instance, can the occasional quantitative assessment be carried out for the entity's own validation, even if not requested or shared with a third party?

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 observe that many private companies first become aware of the nuances of the hedge documentation required for hedge accounting at the time of external audit. Therefore, we do not believe that the proposed amendments in this regard would be as helpful to private companies, unless additional relief is provided. While private companies have become more educated about the benefits of ongoing communications with the external auditor throughout the year, we believe they will greatly benefit if more time is provided to prepare the initial hedge documentation. For example, while providing up to three months from hedge inception to prepare this documentation will be incrementally helpful, the maximum benefit would be derived if private companies are allowed until the date their financial statements are available for issuance to complete the documentation. This also will be in accordance with paragraph BC16 of the basis for conclusions in ASU 2014-03.[2] Further, we observe that if the extended documentation period allows for hedge accounting to be applied, the proposed same line item presentation for both the hedged item and the hedging derivative would be more reflective of their risk management objective.

If this additional time is provided, some safeguards against improper application already exist, e.g., regulatory guidance would prohibit a private company that has already commenced the process of going public of availing this extension. We also note that it can be clarified that the requirement to assess hedge effectiveness at least every three months still would be applicable, even if the initial documentation completion date is extended until the time the financial statements are available to be issued. In that case, private companies would need to meet this requirement by carrying out the quarterly effectiveness testing also at the same time as the initial documentation completion, although using data that was applicable as of the respective quarterly assessment date(s). This would identify any period before document completion date for which the hedge was not highly effective. Other safeguards are provided in the proposed amendment in paragraph 815-20-25-3(b)(2)(iv)(02), which accelerate the dates by when hedge documentation is to be completed in certain circumstances.

We suggest the Board also redeliberate whether, except for the extended documentation timing and termination value option in ASU 2014-03, other aspects of the simplified hedge accounting

[2] Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach

approach should be extended to all entities. For those private companies that "contemporaneously" document the simplified hedge accounting approach (SHAA) and measure the derivative at fair value, this also would provide a safeguard against SHAA reversal if that entity goes public in the future. Further, if a modified SHAA is extended to all entities, we suggest that public companies be allowed an extended period of time e.g., two weeks to prepare the required "contemporaneous" documentation.

Alternatively, we suggest that the requirements for applying the "critical terms match" method be relaxed such that the key terms for hedges of interest rate risk do not necessarily need to match exactly, but be close enough. For example, a difference in settlement dates of a couple of weeks likely would still result in the hedge being highly effective under a long-haul method, but would preclude use of a qualitative method. We note that the Board has already proposed that if forecasted transactions occur within 31 days of derivatives maturity, critical terms are still assumed to perfectly match. We believe that similar relief should be provided for hedges of interest rate risk e.g., reset dates, settlement dates, etc. unless the Board believes that the critical terms method does not apply to financial items. This would simplify the application of the proposed guidance while still requiring a quantitative assessment if the applicable indicators in paragraphs 815-20-35-2A thru 35-2E can no longer be asserted. With reference to the discussion in paragraph BC139 of the basis for conclusions, it also would align subsequent quarterly assessments under the critical terms match method with the qualitative assessments that can be elected for entities that initially apply a quantitative assessment. Relaxing the requirement for the critical terms to exactly match also would have a broader application than just hedges of interest rate risk.

Presuming that even a de-minimis difference would preclude application of the critical terms match method at hedge inception, we also suggest that to avoid diversity in practice, the Board clarify whether day count (e.g., Actual /360 vs Actual/365), business days (e.g., New York and London vs New York only) and business day convention (e.g., modified following vs modified previous business day) are considered critical terms. We suggest that the Board also clarify whether a qualitative method can be applied to debt that has interest rate reset options, if the entity commits to a single rate. If the criteria for critical terms match method are relaxed and applicable to both financial and nonfinancial hedges, the necessity for retaining the shortcut method that has led to numerous misapplications in the past could be reconsidered. Further, any other guidance that allows assumption of perfect effectiveness, e.g., certain circumstances under the change in variable cash flows method may need to be consequently updated.

We appreciate the Board providing a 31-day period for the forecasted transaction to occur and still assume perfect effectiveness. However, it is unclear from the language in paragraph 815-20-25-84A whether transactions occurring both prior and subsequent to the derivative maturity date can be included in a single hedge. For instance, can all designated forecasted transactions from March 31 to May 31 be hedged by a derivative that matures on April 30? In that case, a 46-day period may be more beneficial as that would encompass the entire quarter. Regardless, an extension to 46-days would be more beneficial as that potentially requires a lesser number of derivatives to be entered into for hedging a series of forecasted transactions during a quarter. We also observe that including both the terms "month" and "31-day period" in paragraph 815-30-55-149c. may be confusing if that period overlaps two months.

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

See our response to Question 13 below.

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 observe that reporting entities generally need a reasonable period of time to absorb and implement a new accounting standards update. We also observe that process enhancements and contractual amendments may be needed to take full advantage of the amendments, for instance hedging a contractually specified component. Therefore, we recommend at least one year be provided prior to the required effective date, with an additional year for nonpublic companies, with an option for all entities to early adopt. While this may affect comparability, we believe that the simplifications in the proposal merit early adoption. We also observe that the existing and proposed disclosures may mitigate some of the concerns in this regard.

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 and disclosures. We observe that the proposed transition method may result in earlier ineffectiveness being recognized in statement of stockholders equity at adoption, before again being subsequently reclassified to income when the hedged item ultimately affects earnings. However, compared to a burdensome retrospective transition or prospective only transition that would result in inconsistency between existing and new hedges, we agree that a modified retrospective transition is an acceptable compromise.

For entities that may have used a "pure" critical terms match method e.g., not documented the method of assessing effectiveness in case the critical terms no longer continue to match, the Board could consider whether similar transition relief as the shortcut method should be provided. That is, we recommend considering whether to allow existing hedge documentation to be modified to incorporate how quantitative assessments of effectiveness would be performed if the entity determines at a later date that critical terms no longer match.

Other Matters:
We observe that entities with multiple derivatives hedging the same series of forecasted cash flows sometimes have difficulty in interpreting and applying the "sufficient specificity" requirement for applying cash flow hedge accounting. Some believe that if a portion of the forecasted transaction no longer becomes probable of occurring, logically the derivative entered into first gets affected. However, practice has generally interpreted that the order in which derivatives get affected needs to be specified in the contemporaneous documentation itself. We believe that clarity in this matter would be beneficial. For instance if the guidance can be changed to allow for a presumption (e.g., First-In, First-Out) unless another method is specified in the documentation, that would provide relief and allow hedge accounting in many of these circumstances.