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November 21, 2016

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

File Reference No. 2016-310

Dear Ms. Cosper:

RSM US LLP is pleased to provide feedback on the proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (the "proposed ASU"). We appreciate the opportunity to be involved with such an important initiative. Many middle-market companies struggle with the complexities of hedge accounting, and we are supportive of the attempt to simplify certain aspects of the accounting and to achieve better alignment of the accounting with the related risk management activities. Please refer to the responses that follow for our insights on the specific questions raised in the proposed ASU.

Responses to Questions for Respondents

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.*

Response: We fully support component hedging of forecasted purchases or sales of nonfinancial assets but do not believe component hedging should be limited to contractually specified components. We are aware that the Board considered and rejected a variation of the contractually specified component model that would have extended to components that are not contractually specified but for which it is the "market convention" to use the component as an underlying basis for determining the price of the overall product. We are aware that this model was rejected due to various concerns outlined in paragraph BC50 of the proposed ASU. We believe more efforts should be put forth to develop a workable variation that would permit component hedging for nonfinancial instruments to extend beyond contractually specified components. A variation may be that changes in a noncontractually specified component may be designated as the hedged risk if management can put forth support to demonstrate that the component is used to determine the price of the overall product or if it is obvious that the component would be used to determine the price of the overall product (e.g., cocoa as a component of chocolate). We believe extending component hedging beyond contractually specified components would be beneficial for various reasons including the following:

- Limiting hedged risks to contractually specified components places too much emphasis on form over substance. As the Board acknowledges in paragraph BC43 of the proposed ASU, "contracts for various types of commodities across various industries generally are based on a traded commodity index plus or minus a basis differential…"

- While the statement is made in paragraph BC50 of the proposed ASU that "in situations in which a market convention exists contracts could be rewritten to contractually specify the convention…*",* we believe that smaller reporting entities may be disadvantaged by having less bargaining power to rewrite contracts. Additionally, there are costs associated with rewriting contracts.
- If the hedged risk is limited to contractually specified components, at-market (noncontractual) purchases or sales would not be eligible to be included in the pool of hedged forecasted transactions. It is not uncommon for companies to make some level of at-market purchases or sales rather than commit to contractual prices and quantities given imprecision associated with forecasting.

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.

Response: We believe a principles-based approach would be preferable as it would eliminate the need to update the current list; however, we are not aware of any significant issues associated with maintaining a list nor are we aware of rates that currently should be added to the list.

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.*

Response: We believe that even in those circumstances when the current market yield of the financial instrument is below the benchmark rate at hedge inception, entities should be permitted to use only the cash flows associated with the benchmark rate when calculating the change in the fair value of the hedged item attributable to interest rate risk. We do not believe there is sufficient justification to require that total contractual coupon cash flows be used given that the economics are the same regardless of whether the spread to the benchmark rate is positive or negative.

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?*

Response: We are aware of divergent views in practice that range from bright-line tests such as "two or more occurrences is a pattern" to approaches that focus on whether the circumstances under which a hedged forecasted transaction did not occur could have been reasonably anticipated. We believe it would be beneficial to reduce divergence in practice by providing guidelines to use in determining whether a pattern exists and making it clear that this is not a bright-line test. We are in favor of an approach that gives consideration to factors such as whether the circumstances could have been reasonably anticipated and how significant the transaction that did not occur is in relationship to the total level of similar forecasted transactions the entity hedges. In other words, a missed forecast that is only a small portion of the total population of similar hedged transactions should be viewed differently than a missed forecast that constitutes a significant portion of the total population, all other things being equal.

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.*

Response: The most notable differences we are aware of pertain to the following:

- IFRS 9 does not prescribe where on the income statement hedging activities should be presented
- IFRS 9 requires hedge ineffectiveness to be measured and recognized
- Rather than limiting hedged risks to contractually specified components, IFRS 9 permits component hedging if the component is separately identifiable and can be reliably measured

In addition to the above, we would also point out that IFRS 9 permits the hedged item in a fair value hedge to be a layer of an asset or liability rather than a proportion of the asset or liability. We would encourage the Board to adopt a similar approach as that is another simplification that is much needed in terms of facilitating fair value hedges of a portion of an interest-bearing financial asset or liability.

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.

Response: We are in agreement with the presentation decisions as they simplify the accounting and promote consistency.

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.

Response: We are in agreement with the proposed disclosure amendments in (a) and (c) if feedback from preparers and the users of financial statements supports that the benefits outweigh the costs of these additional disclosures. As it relates to (b), we do not believe that it is appropriate for the financial statement footnotes to include a discussion of goals and whether the entity met its goals.

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.*

Response: We are in agreement with the proposed change as we believe relief from ongoing quantitative assessments will significantly reduce costs, without sacrificing the integrity of reported amounts in that qualitative assessments will still be required. Additionally, we believe the circumstances in which an initial quantitative test will be required are reasonable in light of the proposed improvements that facilitate application of the shortcut method and critical terms match approach.

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.*

Response: We believe it is possible that situations will arise such that an entity would no longer be able to assert qualitatively that a relationship is highly effective yet demonstrate quantitatively that it is. Some examples (to name a few) include (1) an entity is hedging variable rate debt that has different interest rate options and decides at some point to elect a different rate option than the one on which the initial quantitative assessment of effectiveness is based, (2) a market disruption occurs and as a consequence, an underlying interest rate or commodity price index that historically has been highly correlated begins to display a notable level of lessening in correlation and (3) a rate in a variable rate financial instrument or a price of a nonfinancial asset begins to approach a cap or floor. In any of these examples, there could be varying degrees of ineffectiveness introduced into the hedging relationship such that it may or may not remain highly effective when tested quantitatively. Additionally, the change in facts and circumstances that necessitated the quantitative assessment could be temporary. We believe entities should be encouraged to contemplate reasonably possible scenarios in the initial quantitative assessment of effectiveness, such that in the event a subsequent change in circumstances occurs that is within the boundaries of what was previously quantitatively demonstrated to be highly effective, the qualitative assessment could continue. In those circumstances that warrant subsequent quantitative testing, we strongly believe that if this testing demonstrates the hedge was and continues to be highly effective, an entity should be allowed to return to qualitative testing if and when justified by the facts and circumstances. We do not see a reason for the criteria to return to qualitative testing to be different from the criteria proposed at ASC 815-20-35-2C and ASC 815-20-55-79G to initially apply it. If, as proposed, the decision is made that a return to qualitative testing will not be allowed after a significant change in facts and circumstances, we believe the FASB should clarify the intent of the following statement in BC85 and potentially capture it in the body of the ASU:

> *However, the Board also notes that if an entity documented at hedge inception that it would perform subsequent qualitative effectiveness assessments, it would not be precluded from performing occasional subsequent quantitative assessments to a third party to prove the qualitative assessment is valid. It would not be required to perform all effectiveness assessments on a quantitative basis thereafter if the results of that test show that the hedging relationship was and continues to be highly effective.*

We find this statement to be very confusing and believe it will encourage delayed rather than timely quantitative assessments as facts and circumstances change in that entities who are proactive in identifying a significant change in facts and circumstances and perform a quantitative analysis would not be permitted to return to a qualitative analysis. However entities that are not proactive but are rather reactive to a request of a third party will be permitted to continue to assess effectiveness qualitatively. This will lead to audit issues related to the subjective determination of whether changes in facts and circumstances warranted the quantitative assessment or it was performed to prove to a third party that the qualitative assessment is valid.

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.*

Response: We are in agreement with this proposed amendment as it can be challenging for smaller less sophisticated entities to both prepare the hedge election and perform the initial quantitative testing at the inception date. Refer also to our response to question 11 related to further relief for private companies.

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.*

Response: Despite the simplifications and improvements proposed in the ASU, we believe many private companies will continue to struggle to comply with the content and therefore the timing of the hedge election. In our experience, while private companies that use derivatives for risk-management purposes generally understand the economics of the derivative and are good at entering into the appropriate derivatives to meet their objectives, they continue to struggle with the formal documentation required to designate a hedge as it is something that is done only for accounting purposes and is often at odds with how they economically view the hedge. Complexities primarily relate to the most beneficial way to structure the hedge (e.g., as a fair value hedge of inventory or cash flow hedge of a forecasted sale), the most appropriate way to define the hedged item or transactions (e.g., as a specific sale or the first $X of sales occurring in a specific time period) and the method(s) that will be used to assess effectiveness.

While we understand that it is important for an election to apply hedge accounting to be in place at the inception of a hedge so that entities cannot retroactively decide based on the outcome, we strongly encourage the FASB to reduce and simplify the documentation that a private company needs to have in place at the inception of the hedge. Consideration could be given to requiring the inception date documentation for all hedges entered into by private companies to include an indication of the intent to apply hedge accounting, an identification of the hedging instrument and the objective of the hedge. We believe consideration should be given to allowing private companies up to the time annual financial statements are available to be issued to demonstrate that the hedge was effective and fully comply with the documentation requirements. We do not believe that the application of hedge accounting should be heavily dependent upon whether an entity “dots all i’s and crosses all t’s” but rather on the intent of the party (as evidenced by the inception date election) and the effectiveness of the hedge, even if that determination is not made until the end of the year. We believe that the requirement to assess effectiveness for similar hedges in a similar manner will appropriately mitigate the risk that an entity will selectively choose whichever method works at the time.

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

Response: We recommend entities that are not public business entities be given an additional year to become educated about the ASU and prepare for adoption.

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?*

Response: We believe at least a full year subsequent to the issuance date of the standard should be allowed for implementation, with early adoption permitted. As indicated in our response to question 12, we believe entities that are not public business entities should be given an additional year for implementation.

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.*

Response: We are in agreement with the proposed transition method and related disclosures. Additionally, we have no strong objections regarding the decision not to allow a retrospective transition approach.

We appreciate this opportunity to provide feedback on the proposed ASU and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Rick Day at 563.888.4017 or Faye Miller at 410.246.9194.

Sincerely,

RSM US LLP

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