



December 15, 2016

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

Re: **File Reference No. 2016-310**, Proposed Accounting Standards Update (Topic 815), *Targeted Improvements to Accounting for Hedging Activities*

Dear Ms. Cospers:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update (Topic 815), *Targeted Improvements to Accounting for Hedging Activities* (Proposal),

The IMA is a global association representing over 80,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy Activity, Financial Reporting Committee).

We strongly support the objectives of the Proposal to simplify the accounting for derivative financial instruments and the related exposures and improve the relationship of accounting and risk management procedures, while maintaining appropriate information for users of financial statements. In that regard we particularly support the following important aspects of the Proposal.

- For cash flow hedges of a forecasted purchase or sale of nonfinancial assets, allowing an entity to designate as the hedged risk the variability in cash flows attributable to changes in a contractually specified component stated in the contract.
- For cash flow hedges of interest rate risk of variable-rate financial instruments, allowing an entity to designate as the hedged risk the variability in cash flows attributable to the contractually specified interest rate.
- For fair value hedges of interest rate risk, adding the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate as an eligible benchmark interest rate.
- Allowing an entity to measure the hedged item in a partial-term fair value hedge of interest rate risk by assuming the hedged item has a term that reflects only the designated cash flows being hedged.



- In certain circumstances, permitting an entity to measure the change in fair value of a hedged item on the basis of the benchmark rate component of the contractual coupon cash flows determined at hedge inception, rather than on the full contractual coupon cash flows.
- Giving an entity more time to perform the initial prospective quantitative assessment of hedge effectiveness.
- In instances in which initial quantitative testing is required, allowing an entity the option to perform subsequent assessments of hedge effectiveness qualitatively, unless facts and circumstances change.

We do have several suggestions that we believe should be incorporated in the final Accounting Standards Update (ASU) as explained in the rest of this letter. Assuming that the Board addresses these suggestions appropriately, we believe it will have achieved the objectives of the Proposal and the final ASU will represent a significant improvement.

Designating Risks

The FRC believes that permitting a reporting entity to hedge a contractually specified component in a purchase or sale of a non-financial asset will increase the circumstances in which a reporting entity will be able to achieve hedge accounting. However, we believe the FASB should go further and substantially converge with the guidance in International Financial Reporting Standards (IFRS) No. 9, *Financial Instruments*, by allowing entities to designate a "separately identifiable and reliably measurable" risk component.

We are concerned that, by limiting the ability to hedge designated risks to only those that are contractually specified, there may be many arrangements where the pricing is highly correlated with an index but would not qualify for a hedge-by-risk approach because the index is not contractually specified. Because of the difficulty of meeting the highly effective threshold for hedging the entire change in fair value or cash flows, those arrangements would continue to be reported in a way that is inconsistent with sound risk management practices. We do not believe users are best served by that portrayal. Given the concerns expressed in paragraph BC50, we encourage the Board to conduct additional outreach to learn how reporting entities become comfortable that their hedging relationships are economically sound when the hedged item does not include a contractually specified component.

We also believe that a principled definition for a benchmark interest rate is preferable versus a limited set of eligible benchmark interest rates for fair value hedges of interest rate risk. While the current and proposed benchmark interest rates should be maintained as examples, we believe a principled definition similar to the IFRS "separately identifiable and reliably measurable" concept is essential as it is likely that new benchmark indexes will develop as international and financial market activity continues to expand. A principled definition would then avoid scenarios that result in entities' risk management abilities being restricted due to a limiting set of historical benchmark interest rates.

Contractually Specified Component

Paragraph 815-20-25-22A requires that, in addition to the purchase or sale contract creating an exposure to variability in cash flows attributable to changes in the contractually-specified component, the stated components of the price of the nonfinancial asset all relate to the to the cost of purchasing or selling the nonfinancial asset in the normal course of business in the particular market and that those components reflect



market conditions at contract inception. Given that the reporting entity is seeking to hedge a designated risk, we do not understand why the additional criteria relating to the pricing components are necessary. Further, we note that the Board did not require any additional criteria relating to hedges of a risk component of a financial asset or liability (or the forecasted acquisition or issuance of a financial asset or liability). If these criteria are maintained in the final ASU, we believe the Basis for Conclusion should be expanded to explain why the additional criteria are needed as it is not clear to us. The discussion in paragraph BC48 and its reference to “additional safeguards” does not sufficiently explain the need for those additional criteria. If the Board is attempting to limit the ability to embed other derivatives into the contract for the purchase or sale of the nonfinancial asset, we believe the embedded derivative guidance should be sufficient to address those concerns.

Recognition and Presentation of the Effects of Hedging Instruments

We do not agree that the effect of the hedging instrument must be in the same income statement line as the hedged item. Rather, we believe the current accounting requirement that allows entities to separately report ineffectiveness, the effects of components excluded from a hedge strategy, (i.e., forward points and options premiums), and the effects of failed forecasted transactions should continue.

We believe that users of financial statements for certain industries and/or entities desire to have key performance indicators presented solely with the period settlement/accrual amounts of the hedged item and instrument. We believe the Proposal’s requirement to include all effects in the same line item may result in additional non-GAAP measures to allow interested parties (e.g., analysts) to understand the ineffective portion of the hedged items and/or hedged instruments that are included in the effected key performance indicators.

At a minimum, the FASB should perform additional outreach to users of financial statements across multiple industries to ensure that there is significant support for the proposed approach of recognizing the effect of the hedging instrument in the same income statement line as the hedged item. Alternatively, we believe the Proposal could be changed so that, for example, the period settlement amounts on a hedged item and the period net settlement on the hedging instrument are allowed to be solely included in the margin with all other measurement effects of the hedge recognized in another line item (with adequate disclosure) in the income statement.

Subsequent Assessments of Effectiveness

We agree with the Board’s decision to allow an entity to perform an initial quantitative test of hedge effectiveness and then perform subsequent hedge effectiveness assessments qualitatively unless facts and circumstances change. However, we do not agree with the Board’s decision to prohibit qualitative testing after an entity determines that subsequent to the qualitative assessments a quantitative assessment of effectiveness is required in a given period. To perform subsequent qualitative assessments, an entity must be able to establish various factors at the inception of the hedging relationship that it can monitor and, unless there is a change in these factors, enable the entity to reasonably support a continued expectation of high effectiveness. If facts and circumstances change that would no longer allow an entity to rely on its qualitative factors, we agree that a quantitative assessment should be performed as of the period that the facts and circumstances change. However, if the facts and circumstances changed again to a scenario that would allow the entity to rely on the various factors that were established at the inception of the hedging relationship to reasonably support that the hedge continues to be highly effective, an entity should be able to fall back to a



qualitative assessment. The prohibition against utilizing the qualitative factors in subsequent scenarios essentially invalidates the reasonableness of the factors as a method to reasonably support a continued expectation of high effectiveness. As an alternative to the prohibition, we believe that the Proposal could be changed to include a time frame or other criteria that an entity would need to meet before reverting back to a qualitative analysis.

Below Benchmark Hedges

We do not agree with the Board's decision to require an entity to hedge full contractual coupon cash flows when the current market yield of the financial instrument is below the benchmark rate at hedge inception. It is not clear to us in the Basis for Conclusions why this change from current GAAP is needed. In addition, this proposed change will make it more difficult and complex for risk management of these types of financial instruments. We recommend that this limitation be eliminated from the final ASU or, at a minimum, the Basis for Conclusion include a more robust explanation as to why this method allows an entity to better consider the market environment and the economics of the debt instrument being hedged at the time of hedge designation when the risk being managed is interest rate risk.

Disclosures

The Proposal maintains the disclosure requirement in 815-30-50-1(c) to report the estimated net amount of the existing gains or losses that are reported in accumulated other comprehensive income at the reporting date that is expected to be reclassified into earnings within the next 12 months. Our members believe that this disclosure has not been useful to users as the amounts disclosed generally change over the next 12 months. Further, the complexities of estimating the amounts for hedge strategies involving interest rate swaps are particularly complex due to the recent (volatile) yield curves and can result in substantial changes between a period-end estimate and the issuance of the financial statements, let alone the next 12 months. As a result, we do not believe that amounts are being estimated consistently in practice. Due to the complexities, inconsistencies and operational burdens of estimating the amounts applicable to this disclosure, we recommend that the final ASU remove this as a required disclosure.

Our members are not in favor of the proposed disclosure amendments that require an entity to disclose the quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals. For many entities, hedge strategies are done on an instrument or product-specific basis which is then utilized in entities' overall risk management strategies and practices. These risk management practices are designed to be flexible and to react and/or change as various facts and circumstances change. Further, what if hedge accounting is not elected? The above requirement will be difficult to apply, and, as a result, will not provide useful information, and could provide information that is misleading. In addition, we believe that information of this type is more appropriate in the Management Discussion and Analysis section of the Form 10-K.

We also believe that the additional disclosures added to ASC 815 in the Proposal should be limited to year-end only. We are concerned with the recent trends in the amount of disclosures that are applicable to all periods. We believe in an integrated approach to interim disclosures in which disclosures are updated in interim periods only when there are significant changes in facts and circumstances. Otherwise, we believe the cost outweighs the benefit for interim reporting.



Transition

We recommend the Board consider whether the transition requirements that an entity record

- the cumulative effect of the application of the proposed recognition requirements in accumulated other comprehensive income (OCI) for cash flow hedges and
- the cumulative translation adjustment section of OCI for net investment hedges with a corresponding adjustment to the opening balance of retained earnings as of the most recent period presented on the date of adoption

could be simplified in a prospective application. Under a prospective approach, the prior period ineffectiveness, which is the amount that would be included in the proposed transition adjustment, would simply remain in prior period results versus being recorded in OCI and then recycled through earnings. Although under a prospective approach, a variance in the application of certain hedge accounting methods will exist related to how ineffectiveness is recognized within an ongoing hedge strategy (i.e., where under the Proposal ineffectiveness is included with the effective portion of the hedge results), our members are not concerned with this variance since prior period earnings are not being restated.

The proposed transition method results in a reporting variance since the amount recognized at adoption in OCI would be recycled in future periods, while the prior period income statements would retain that transition amount. Essentially, the transition method results in the ineffectiveness being recognized in multiple periods. This could have the unintended consequence of entities having to report non-GAAP measures in earnings releases to help the analysts understand the core amounts. In addition, there will be operational costs (e.g., personnel time, system changes, etc.) of determining the cumulative adjustment. Another consideration is that because the transition amounts are the prior period ineffectiveness, the amounts should not be substantial. As we believe that many entities will want to early adopt the final ASU, these costs of implementation will be incurred at the same time that entities are incurring costs associated with implementing other new standards (i.e., Revenue Recognition, Credit Losses, Leasing). Due to the minimal benefits of a modified retrospective approach compared to its costs, we recommend a prospective application for the above hedges be permitted with disclosure.

Further, we note that, historically, the Board has made changes affecting Topic 815 effective on a prospective basis. We do not see why that should change now.

We would be pleased to discuss our comments with the FASB or its staff at your convenience.

Sincerely,

A handwritten signature in blue ink that reads "N. Schroeder".

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Institute of Management Accountants
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