



December 19, 2016

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

File Reference No. 2016-310

The Accounting Principles Committee of the Illinois CPA Society (“Committee”) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update (“ASU”), *Derivatives and Hedging: Targeted Improvements to Accounting for Hedging Activities* (Topic 815). The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

In general, we believe the proposed ASU is a step in the right direction. Permitting companies to subsequently assess whether a derivative is expected to be highly effective in offsetting changes in the cash flows or fair value of a recognized asset, liability, firm commitment, or anticipated transaction on a qualitative basis and not requiring the computation and recognition of ineffectiveness as long as the derivative is expected to be highly effective will significantly simplify hedge accounting. However, as noted in our responses to the questions from the proposed ASU below, while the Financial Accounting Standards Board (“FASB” or the “Board”) decision to permit hedging a contractually specified component of a purchase or sale of a non-financial asset will allow many more transactions to qualify for hedge accounting, we do not believe the Board has gone far enough with respect to hedging risk components.

We have provided our responses to certain questions raised in the proposed ASU below.

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 believe the Board should fully converge with International Financial Reporting Standard (“IFRS”) No. 9 *Financial Instruments* and permit designating risk components that are separately identifiable and reliably measurable, even if those risk components are not contractually specified. We are concerned that, while the Board’s proposed approach will certainly enable reporting entities to hedge the purchase or sale of non-financial assets with less difficulty than under today’s model, it would not permit a reporting entity to hedge a risk component of transactions where the pricing of the purchase or sale implicitly considers a market index, rate or price. We understand the Board’s concerns about broadening the identification of risk components, but the proposed ASU will continue to require many reporting entities to attempt to qualify for hedge accounting based on the entire change in cash flows or fair value of the non-financial asset, a result that would be impossible to obtain without a contractually specified risk component. Accordingly, the reporting entity’s financial statements will still not reflect its risk management practices. We encourage the Board to conduct further outreach to reporting entities who hedge risk components of purchases or sales of

non-financial assets when those risk components are not contractually specified to understand how those reporting entities obtain comfort that their hedging strategies are effective prior to finalizing the proposed ASU.

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.

Response: While we believe the Board should retain the existing list of benchmark interest rates for fair value hedges of fixed-rate financial instruments, we believe it should develop a principle for identifying benchmark interest rates so that, as financial markets continue to develop, practice will have a basis for determining whether an interest rate has become a benchmark rate. That way, the marketplace would not have to wait for the Board to conduct due process and amend Topic 815 to add a new rate 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 do not agree with the Board's decision to prohibit designating the benchmark rate as the hedged risk when the market yield of the hedged item is less than the benchmark rate. The Board's decision will result in a reporting entity recognizing ineffectiveness for changes in its credit risk, even though it did not intend to hedge changes in the fair value of the hedged item due to changes in its own credit risk. We do not believe those results provide users of financial statements with an accurate reflection of the reporting entity's hedging activities.

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: As a committee, we do not have a policy on what constitutes a pattern. However, we believe any policy would need to consider the facts and circumstances behind a conclusion that a forecasted transaction is probable of not occurring to determine whether that conclusion calls into question the reporting entity's ability to conclude that a forecasted transaction is probable of occurrence. If a reporting entity determines that a forecasted transaction is probable of not occurring due to factors outside of its control, we do not believe that transaction would be considered when determining whether the reporting entity has established a pattern that raises questions about its ability to accurately predict forecasted transactions. We further believe that the reporting entity should consider the frequency with which it has determined a forecasted transaction is not probable of occurring, as well as the volume of transactions. We do not believe a low frequency of occurrence or a low percentage relative to the total volume of transactions should be sufficient to establish a pattern that would suggest the reporting entity is not capable of reliably forecasting transactions.

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 do not agree with any of the Board's conclusions on presentation of the results of hedge accounting and see no reason to change how reporting entities present the results of hedge accounting, particularly given the fact that Topic 815 has been effective for more than 16 years. We do not believe the Board should now prescribe how an entity reports hedge transactions. We note that users currently receive information under paragraph 4C of ASC 815-10-50 that would enable them to obtain the same presentation the Board now seeks to mandate. If the Board's proposed presentation is superior to how reporting entities present the results of hedge transactions currently, we do not understand why the Board believes a reporting entity should continue to disclose the amount, if any, excluded from the assessment of hedge effectiveness. That decision seems contrary to a view that reporting all changes in the fair value of the derivative in the same line as the hedged item is reported provides relevant information to users. If that information is still relevant to users, we see no reason to require the presentation prescribed in the proposed ASU.

If the Board decides to proceed with the guidance on presentation, we would recommend further outreach with users of financial statements to ensure those users are, in fact, in agreement with the Board's approach. We are concerned that reporting entities will need to develop additional non-GAAP financial measures to provide users with information they find relevant.

Question 7: Do you agree with the proposed disclosure amendments in (a), (b), and (c) below? Please explain why or why not.

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

Response: We do not agree with the Board's decision to require reporting entities to disclose quantitative hedge accounting goals. While that disclosure may be appropriate for reporting entities that have fairly static hedge strategies, it would not provide an accurate picture (other than possibly as of the first day of the fiscal

year) for reporting entities that continually review and revise the strategies used to meet their risk management objectives. For such reporting entities, measuring whether it satisfied the goal at the beginning of the year would not provide meaningful information to users because the entity may have changed that goal in response to changes in the types of assets it holds, the types of liabilities it uses to finance the business, or changes in economic conditions.

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: While we do not object to the revised tabular disclosure, we note that continuing to require reporting entities to disclose the amount, if any, excluded from the assessment of effectiveness calls into question the conclusion that such amounts should be presented in the same line as the results of the hedge transaction.

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 agree with the proposed change as it will significantly reduce the administrative burden of applying hedge accounting for those arrangements that, while not qualifying for the short-cut approach, are not expected to result in significant amounts of ineffectiveness.

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 a reporting entity should be able to revert to making a qualitative assessment if facts and circumstances have changed again such that the entity reasonably believes that a qualitative assessment would be appropriate. As part of concluding that a qualitative assessment would be appropriate, a reporting entity would presumably have an understanding of the factors that originally caused it to conclude that a qualitative assessment was no longer appropriate and would be able to point to why those factors are not reasonably expected to recur in the future. Further, we believe a reporting entity should be able to continue making a qualitative assessment if the nature of the change in facts and circumstances indicates that the change in the relationship between the derivative and the hedged item is temporary, such as market upheaval caused by events that are not expected to recur (for example, the termination of trade agreements or commodity price shocks).

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 agree with providing reporting entities with additional time to perform their initial quantitative assessment of effectiveness. Providing additional time to perform an effectiveness test would have no effect on the financial statements, unlike the potential effect of allowing a reporting entity to designate and document the hedge transaction at future date, which would allow the entity to determine whether the hedge is effective and, if not, identify a different exposure as the hedged item. If a transaction does not pass the initial quantitative assessment, it does not matter whether the reporting entity identifies that on the date it enters into and designates the derivative as a hedge or at the end of the reporting period; it will still report the change in the fair value of the derivative in earnings for that reporting period.

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: We believe all reporting entities should prepare their hedge documentation at the time they designate a derivative instrument as a hedge of an existing asset or liability, firm commitment, or anticipated transaction.

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

Response: We believe an effective date of one year after the effective date for public business entities would be appropriate for private companies, with early adoption permitted.

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 agree with the Board's decision not to allow a retrospective transition approach. However, we do not understand why transition is not prospective, as it has been historically with amendments to Topic 815.

Other Comments

Given the Board's decision to permit reporting entities to assess effectiveness qualitatively for a broader population of hedge transactions than was previously allowed under Topic 815, we question the continued need for the matched-terms method in paragraph 84 of ASC 815-20-25. The main objective of that paragraph was to provide for circumstances where a qualitative assessment of effectiveness would be possible. Since the proposed ASU extends the ability to assess effectiveness qualitatively and eliminates the requirement to measure and recognize ineffectiveness on all arrangements that qualify as effective, it no longer seems that the matched-terms method would be necessary. Therefore, we recommend that the Board consider eliminating that guidance.

In contrast, we agree with the decision to retain the short-cut method. However, we believe the Board should eliminate the condition in paragraph 104(g) of ASC 815-20-25. We suspect that condition has been behind many of the restatements involving the improper application of the short-cut method due to its subjectivity. We believe the remaining criteria for determining when it is appropriate to apply the short-cut method are objective and therefore are not as susceptible to second-guessing as the condition in paragraph 104(g). If the Board were to eliminate the condition in paragraph 104(g), we would favor eliminating the guidance added

by the proposed ASU allowing a reporting entity to document how it would assess effectiveness if it were determined that the entity did not qualify for the use of the short-cut method.

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We appreciate the opportunity to provide our comments and observations on the proposed ASU and would be pleased to discuss them with the Board members or the FASB staff at your convenience.

Sincerely,

Ryan Brady, CPA

Chair, Accounting Principles Committee

Brian Kot, CPA

Vice Chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2016-2017

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

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Christopher Hamm, CPA	Artex Risk Solutions, Inc.
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Joshua Shenton, CPA	Northern Trust Corp.
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