



August 15, 2008

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Submitted to: director@fasb.org

Re: File Reference Number 1590-100, Proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities- an Amendment of FASB Statement No. 133

Dear Mr. Golden:

The American Gas Association ("AGA") is pleased to have the opportunity to respond to the request for comments from the Financial Accounting Standards Board on the proposed amendment to accounting for derivative instruments and hedging activities.

The AGA, founded in 1918, represents 202 local energy companies that deliver natural gas throughout the United States. There are nearly 70 million residential, commercial and industrial natural gas customers in the U.S., of which 92 percent — more than 64 million customers — receive their gas from AGA members. Today, natural gas meets almost one-fourth of the United States' energy needs. Many of these companies use derivatives contracts to help hedge the cost of natural gas to residential, commercial and wholesale customers. We appreciate the FASB's willingness to re-examine the accounting for derivatives and to attempt to simplify its' application.

We are in support of the provisions that actually simplify the standard. However some of the proposed changes will be problematic: the inability to de-designate hedging relationships; the disallowance of designating risks that are hedged; the elimination of the shortcut method and critical terms matching. We also question whether changes to US GAAP make sense when US public companies are on the threshold of convergence of US GAAP to International Financial Reporting Standards.

The following comments respond specifically to the issues presented by FASB staff in the proposed statement.

## Issue 1, Hedged Risk

We do not agree with disallowing the bifurcation of risk as proposed. When entities report all the changes in the value of the hedged item, including the non-hedged portion, and the changes in value of the hedge, the difference between the two will create earnings and balance sheet volatility. Volatility in carrying values and unrealized gains and losses continue to be hurdles for financial statement readers when understanding the economics of our businesses. We support the concerns expressed by certain board members about the difference and potential distortions to earnings when the fair values for the hedged item are inconsistent with the change in fair values of the hedging instrument.

The discussion surrounding bifurcation of risk has been directed primarily to financial hedges. We strongly believe that commodity hedges should similarly be permitted to be bifurcated. For instance, companies that work with commodities should be able to bifurcate the exposures that are hedged using commodity hedging instruments. With the focus on financial instruments, commodity exposures have been well overlooked.

#### Issue 2, Hedged Risk

We strongly support provisions that permit the reporting entity to designate individual risks as the hedged risk as a general risk, not just for these exceptions.

#### Issue 3, Hedge Effectiveness

We do not foresee significant operational concerns or constraints pertaining to effectiveness testing calculations. For many hedging relationships, the shortcut method and critical terms matching have been relied upon for testing purposes. If those methods are allowed to remain in practice, then the reduced effectiveness testing level that is proposed will be easily met. The extent to which more hedging relationships would be expected to be designated under the new guidance will depend on the definition of "reasonably effective."

We believe that the elimination of the shortcut method and critical terms matching are more of an operational matter for risk managers than a financial statement reader issue. Operationally, we believe that these parameters have been very useful and should not be eliminated. We believe the result could complicate the documentation and accounting for plain vanilla hedging relationships, particularly hedges of interest rates, if bifurcation of risk is allowed to continue. We continue to be concerned about the increasing administrative burden that this standard has warranted, and discourage elaborate effectiveness testing methodologies.

## **Issue 4, Hedge Effectiveness**

We support the proposed allowance for reporting entities to apply hedge accounting, relying on a "reasonably effective" threshold for effectiveness testing purposes. We believe that this would result in companies accurately reflecting the economics of risk management activities in the results of operations and provide a greater benefit to the users of financial statements.

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We are somewhat concerned, however, about the new "bright lines" that may well develop over time, with the subjective "reasonably effective" threshold. We believe that the FASB should provide additional guidance to reinforce a principles-based approach for entities to employ in assessing whether a hedge is "reasonably effective." We think that the evaluation of hedge effectiveness should be based on the relevant facts and circumstances, and involve management's judgment.

It is possible that there are some very effective hedging strategies that will no longer qualify as effective hedges. As an example, consider forward starting swap arrangements that lock in an interest rate on forecasted debt issuances. To the extent that the FASB will disallow the designation of interest rate risk as the hedged item, this legitimate risk management strategy and hedging relationship would not qualify under the proposed amendments to FAS 133.

Alternative hedging strategies would need to be investigated under the amended standard, and companies would incur additional administrative burdens for changes, in procedures and internal policies.

# Issue 5, Hedge Effectiveness

As a practical matter, a change of circumstances that would render a hedging relationship as ineffective is rare. Existing controls, practices and procedures in the derivatives operations are adequate to assess when circumstances have changed that would give rise to a change in the hedging relationship. Absent circumstances that change hedging relationships, reporting entities will have fewer occasions to assess effectiveness after inception, and will likely result in a reduction of discontinued hedges.

#### Issue 6, Hedge Effectiveness

We concur with the FASB's decision to require entities to discontinue hedge accounting when the hedge becomes ineffective, provided that the ineffectiveness is expected in the current period. There are situations that may occur when a hedging relationship will become ineffective, especially if bifurcation of risk is disallowed for hedge designation.

#### Issue 7, Presentation of Hedging Gains and Losses

We are reluctant to endorse a one-size-fits-all presentation for derivatives contracts given the diversity of companies that apply US GAAP. We believe that current standards, FAS 161 specifically, provide adequate information concerning where within the financial statements such gains and losses are presented.

# Issue 8, Effective Date and Transition

If the Board approves these proposed amendments, the changes to FAS 133 that disallow the designation of risk will be problematic for companies. There will be a number of hedging relationships that will result in unexpected income recognition because of the anticipated difference between the hedged item and the hedging instrument. We think that additional time is warranted for evaluating and executing strategies that conform to

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the amended standard so to address potential business risks, volatile results in the financial statements, and especially potential distortions to GAAP net income.

## Issue 9, Effective Date and Transition

Possible disclosures would include the disclosure of hedging relationships that were in place under the prior guidance that did not qualify for hedge accounting due to the effective testing standard, and those hedging relationships that were de-designated, and those hedging relationships that now qualify for hedge accounting due to the lower reasonably effective hurdle.

#### Issue 10, Effective Date and Transition

We are in support of the one time fair value option at the initial adoption of this statement, and we agree with the FASB decision to limit the option to assets and liabilities that are currently designated as hedge items under FAS 133.

# **Issue 11, Cost-Benefit Considerations**

We endorse changes that help simplify the compliance while providing meaningful information that fairly portrays the economics of the transactions. The application of FAS 133 has been extremely costly for most companies and not necessarily beneficial to financial statement readers based on analyst remarks during earnings calls. The current standard has required internal and external specialists, and changes to hedging programs, unexpected earnings consequences and expensive restatements.

Thank you for taking the time to consider our concerns. We appreciate the opportunity to address these matters.

Sincerely,

[s] Roy R. Centrella

Roy R. Centrella Chairman, American Gas Association, Accounting Advisory Council Vice President, Southwest Gas Corporation