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Via e-mail: director@fasb.org

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
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LETTER OF COMMENT NO. 110

File Reference No. 1590-100—Exposure Draft, *Accounting for Hedging Activities*

Dear Mr. Golden:

BDO Seidman, LLP is pleased to offer comments on the Exposure Draft (ED) of the Proposed Statement of Financial Accounting Standards, *Accounting for Hedging Activities – an amendment of FASB Statement No. 133*. We applaud the Board's objective of simplifying the accounting guidance for hedging activities, which, as noted in the ED, is often cited as the poster child for overly complex, rules-based accounting standards. However, BDO agrees with the Alternative Views and does not support issuance of the ED as currently drafted. We believe the ED does not achieve its stated objectives and diverges from the hedging guidance in International Financial Reporting Standards.

Consistent with the Alternative Views, we believe that certain of the proposed changes represent an improvement, but we believe the ED does not go far enough to simplify the accounting guidance for hedging activities. In fact, it appears that the Board's approach to simplification was to make hedge accounting so unappealing that few entities would choose to adopt it. We believe the partial rejection of the bifurcation-by-risk approach actually increases complexity and makes application of hedge accounting far more challenging. In addition, we are not convinced that the proposed changes would improve the usefulness of financial reporting on hedging activities.

We also agree with the observations of paragraph A60 of the ED regarding the push towards convergence of accounting standards. We believe it would be unfair and costly to force entities to make substantial changes to their systems and hedging strategies now when they might have to repeat the process (and the costs) once the shift to IFRS occurs.

Therefore, we recommend the Board move forward with the guidance in paragraphs 6-12 of the ED but refrain from making other changes pending developments in the move towards IFRS convergence. We believe the proposed revisions to hedge effectiveness achieve the objectives stated in the ED by simplifying hedge accounting and improving financial reporting. Alternatively, we would support the proposals described in paragraph



A60 of the Alternative Views. That is, we would support a project that adopts the derivatives and hedging provisions of IAS 39. If the Board does not agree with either of these two alternatives, we recommend that the project be dropped in its entirety in anticipation of the results from the overall convergence movement or the project on complex financial instruments.

We have organized our specific comments consistent with the headings in the body of the ED.

Scope

We believe paragraph 5 is misleading. The scope of Statement 133 has not been changed, but certainly the types of items or transactions eligible for hedge accounting are different. Specifically, it appears that certain intercompany transactions involving foreign currency exposures would no longer be eligible for hedge accounting under the ED. We comment further on this proposal under the heading Other Amendments to Statement 133.

Hedge Effectiveness Requirements

We agree with the proposed changes to the requirements for assessing hedge effectiveness. By lowering the required effectiveness threshold and eliminating the periodic effectiveness assessments, the Board both simplifies the accounting and improves financial reporting for hedge activities. However, we recommend the Board provide additional guidance to illustrate the intended application of that guidance. The Board introduces new terminology in the ED such as “reasonably effective,” “reasonable period of time,” and “minimal difference.” We are concerned that without guidance from the Board, diversity in practice will emerge with respect to how different entities determine the following:

- When a quantitative (as opposed to only a qualitative) assessment of effectiveness is required
- Which types of circumstances would suggest that a hedging relationship may no longer be effective
- Whether a difference between forward rates on the actual derivative and the perfect hypothetical derivative is minimal, thus indicating that the time period is reasonable.

We understand that application of the guidance requires judgment, and we are not suggesting that the Board provide prescriptive rules for these situations. But, to achieve consistent application of this “principles-based” guidance, the Board’s intent and meaning must be clear. For example, paragraph A9 of the ED states that all the facts and circumstances must be considered in determining whether a hedging relationship is reasonably effective, including, “consideration of whether the objective of applying hedge accounting was to compensate for accounting anomalies or to achieve a fair value measurement option for items not currently eligible for fair value measurement.” We do not understand what the Board intends by this statement. Does it mean that an entity would



not be allowed to apply hedge accounting due to its “objective” for applying hedge accounting, even if the hedging derivative would be reasonably (or highly, or even perfectly) effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk? If so, where is this point articulated in the amendments to Statement 133 (which is especially important since paragraph A9 will not be included in the Codification)?

Dedesignation of Hedging Relationship

We do not understand the problem paragraphs 13-15 of the ED aim to address. In our experience, entities rarely dedesignate hedge relationships voluntarily, except in response to changes in circumstances or as an overall hedge strategy (such as the one noted in paragraph A12). We do not think dedesignation has been “used as a tool for changing measurement attributes and/or managing the classification of certain items reported in earnings” in practice.

If voluntary dedesignation really is a problem in practice, it is unlikely that the ED would curb such abuse. An entity could simply terminate the derivative and enter into a new derivative with the same hedging objective. Alternatively, the entity could enter into two additional offsetting derivatives, one offsetting the original hedging derivative and the other mimicking the effect of the original hedging derivative. In both of these situations the entity is in exactly the same economic position (except possibly for additional transaction costs), and yet the accounting has changed. We believe this provision merely forces an *entity to jump through another hoop to dedesignate a hedging relationship and certainly does not simplify accounting, improve financial reporting, resolve practice issues, or address recognition and measurement anomalies.*

Similarly, we do not understand why an entity should not be allowed to redesignate the original hedging derivative or the offsetting derivative in a hedging relationship. The Board provides no explanation for this change in the basis for conclusions, and we fail to see the principle that leads to this requirement. Like the preceding paragraph, this requirement is easily circumvented by entering into transactions with little or no overall economic impact.

In addition, paragraph A12 indicates that the ED would not affect many hedge strategies traditionally involving a periodic dedesignation if documented differently, as shown in paragraph B1(ccc). Here again, the ED seems to focus on changes in the form of hedge accounting and documentation rather than anything of substance. Entities can still achieve the same accounting if they document that they will “dedesignate in advance.” This creates additional complexities in preparing hedge documentation, and we believe it will cause considerable difficulties in implementation, especially for smaller entities that lack technical accounting resources. We do not believe this change meets any of the objectives set forth in the ED.

Hedged Risk



We disagree with the Board's rejection of the bifurcation-by-risk approach for the reasons cited in paragraphs A54-A58 of the Alternative Views. The proposed guidance does not provide a faithful representation of the reporting entity's risk management activities and it is unclear to us why the Board believes this approach would be more useful. We are especially concerned that the proposed changes might lead entities to forsake economically efficient and effective hedging strategies due to the adverse accounting consequences.

The resulting guidance effectively requires an entity to adopt the fair value option in order to apply hedge accounting for certain transactions. While the Board provides that this change is "directionally consistent with the goal of measuring all financial instruments at fair value," we believe it does not simplify hedge accounting and appears to overstep the scope of this project.

We further note that the Board's decision to allow exceptions to the general hedging approach creates additional complexity, blatantly conflicting with the first stated objective of the project.

Measurement of Hedged Items in Fair Value Hedging Relationships

For the same reasons noted in the Hedged Risk section, we disagree with the proposed changes to the fair value hedging approach. We suspect that if the provisions of the ED are adopted, many entities will elect not to apply fair value hedge accounting. Other entities, as noted above, may even avoid certain rational risk management transactions due to the accounting treatment that would be required.

Measuring and Reporting Ineffectiveness in Cash Flow Hedging Relationships

For many of the same reasons noted in the Hedged Risk section, we disagree with the proposed changes to the cash flow hedging approach. Consistent with paragraph A58 of the Alternative Views, we believe that the ED:

- Will create significant complexity, especially for small companies, in assessing and measuring ineffectiveness
- Is not operational and does not improve financial reporting
- Might disincline companies from pursuing prudent risk management strategies due to the adverse accounting consequences.

In addition, we disagree with the requirement to record ineffectiveness for underhedges because the "result would be to defer in other comprehensive income a nonexistent gain or loss on the derivative and to recognize in earnings an offsetting nonexistent loss or gain," as stated in paragraph 379 of Statement 133.

Disclosures

If the Board moves forward with the project, we agree that the proposed disclosures are appropriate.



Other Amendments to Statement 133

We are concerned that the changes to paragraphs 13 and 40 of Statement 133 are not explained or supported in the Basis for Conclusions, other than to say that such changes are provided to clarify the original intent of Statement 133.

The revised paragraph 13 appears to indicate that the guidance in that paragraph only applies to features indexed solely to an interest rate index and would not apply to redemption features contingent upon non-interest related events. The proposed changes to paragraph 40 appear to restrict the hedging of foreign currency exposure resulting from an intercompany transaction. The Board apparently views these changes as minor since they did not warrant a mention in the notice to recipients or the basis for conclusions. However, both of these changes go beyond a simple clarification and could potentially have a significant impact on practice.

The lack of any meaningful discussion to explain the Board's reasoning for such changes seems inconsistent with the spirit of the Board's due process procedures and creates a risk that the amended guidance will be misinterpreted or misapplied in practice. We believe a clear communication of the rationale and intent behind accounting guidance is a significant component to reducing complexity in financial reporting. Therefore, we believe that the Board should not make either of these changes until it properly re-exposes them for public comment with a robust discussion of the rationale and an expanded Basis for Conclusions to explain the reasons the proposed changes are considered appropriate.

Effective Date and Transition

If the Board elects to proceed with the project, we recommend deferring the effective date until fiscal years beginning after December 15, 2009. In general, we believe new accounting standards should become effective at the same time each year in order to minimize complexity with respect to application of multiple new rules. In addition, we believe entities will need time to examine their current hedging strategies and consider whether changes are needed as a result of the guidance in the ED.

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We would be pleased to discuss our comments with the FASB staff. Please direct questions to Ben Neuhausen at 312-616-4661.

Very truly yours,
s/ BDO Seidman, LLP