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Technical Director
Financial Accounting Standards Board
of the Financial Accounting Foundation
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Dear Board Members:

TransCanada Corporation (TransCanada) is pleased to submit its comments in response to the Invitation to Comment on Selected Issues about Hedge Accounting as issued by the US Financial Accounting Standards Board (FASB), together with the International Accounting Standards Board (IASB) (the “Boards”) Exposure Draft on Hedge Accounting.

TransCanada is a leader in the responsible development and reliable operation of North American energy infrastructure including natural gas and oil pipelines, power generation and gas storage facilities. TransCanada’s network of wholly owned natural gas pipelines extends more than 60,000 kilometres (37,000 miles), tapping into virtually all major gas supply basins in North America. TransCanada is one of the continent's largest providers of gas storage and related services with approximately 380 billion cubic feet of storage capacity. A growing independent power producer, TransCanada owns, or has interests in over 10,800 megawatts of power generation in Canada and the United States. TransCanada is developing one of North America’s largest oil delivery systems.

TransCanada strongly supports the Boards’ goal to improve and simplify standards for financial reporting of financial instruments and, at the same time, provide users with transparent and more complete information.

Our key concerns with the Exposure Draft are summarized below:

1) TransCanada strongly believes that the content within the Exposure Draft needs to be expanded for the hedge ratio and rebalancing concepts to provide clarification and ensure consistency of interpretation and application. Furthermore, the proposed transition timing requirements should be extended to provide sufficient time for implementation.

2) TransCanada strongly disagrees with the proposal of not permitting voluntary discontinuation of hedge accounting for a hedge relationship. Risk management objectives can be dynamic. As such, a designated hedge could meet the qualifying criteria for effectiveness without remaining optimal for a dynamic or evolving risk management strategy. In these situations, rebalancing of the hedge ratio may not be the best solution for risk
management. Rather the discontinuation of the existing hedge accounting and entering into a new hedge would better optimize the risk management strategy. Therefore, TransCanada believes hedge discontinuation should be done when the entity’s risk management takes action, for a business purpose, to change the hedging relationship.

3) TransCanada strongly disagrees with the proposal to provide disclosure of the monetary amount or other quantity to which the entity is exposed for each particular risk. This is competitively sensitive information and may influence our company’s decision to apply hedge accounting. Overall, TransCanada is concerned that the additional disclosure in the proposal will overload the financial statement users with the complexities of risk management strategies and hedging information while not enhancing (and likely diminishing) the understandability of the company’s financial situation.

4) TransCanada strongly believes the criteria for contracts that would otherwise meet the current ‘own use’ scope exemption only in instances where it is in accordance with the entity’s fair value-based risk management strategy is too restrictive and entities may find it difficult to comply with the requirements. Therefore, we believe that an entity should have the option to designate ‘own use’ contracts at fair value in instances where it can sufficiently demonstrate the election eliminates or significantly reduces accounting mismatch in accordance with risk management activities.

5) TransCanada believes a final standard on hedge accounting should not be issued prior to the issuance of the complementary Exposure Draft on open portfolio or macro hedging to ensure achievement of a consistent and comprehensive hedge accounting standard to be applied globally. As such, and given the expectation that implementation will be complex and require a significant amount of time, TransCanada disagrees with the proposed transition timing requirements and proposes prospective adoption no earlier than January 1, 2014 to provide sufficient time for implementation.

Overall, TransCanada encourages the Boards to achieve convergence of International Financial Reporting Standards (IFRS) with US Generally Accepted Accounting Principles (US GAAP) in their overall standards on derivatives and hedging activities to enable comparability of financial information between companies.

TransCanada hopes its comments will be useful to the FASB as it continues its deliberations to improve and simplify its hedge accounting guidance and as part of its plan to participate in the joint IASB and FASB discussions of the comments received on the Exposure Drafts. If you have any questions or would like to discuss any of these matters, please do not hesitate to contact us.

Also, please find attached our comment letter in response to the Invitation to Comment on Selected Issues about Hedge Accounting as issued by the FASB, together with the IASB Exposure Draft on Hedge Accounting.

Yours very truly,

G. Glenn Menuz, C.A.
TransCanada Corporation
Vice- President and Controller
APPENDIX – Response to the Invitation to Comment on Selected Issues about
Hedge Accounting

TransCanada’s responses to selected questions are set out below.

Risk Management

Question 1: When an entity uses financial instruments to manage risk exposures in economic hedges but those instruments are not designated in hedging relationships for accounting purposes, do you believe that the proposed guidance would provide useful information about all of the effects of an entity’s risk management objectives?

Question 2: Do you believe that the proposed guidance and illustrative examples included in the IASB’s Exposure Draft are sufficient to understand what is meant by risk management, how to apply that notion to determine accounting at a transaction level, and how to determine the appropriate level of documentation required? Why or why not?

Question 3: Do you foresee an entity changing how it determines, documents, and oversees its risk management objectives as a result of this proposed guidance? If yes, what changes do you foresee? Do you foresee any significant difficulties that an entity would likely encounter in establishing the controls related to complying with the proposed guidance?

Question 4: Do you foresee any significant auditing issues arising from the proposed articulation of risk management and its link to hedge accounting? For example, is the information required to be disclosed regarding an entity’s risk management strategies measurable and objective? Could the inclusion of an entity’s risk management objectives create an expectation gap that the auditor is implicitly opining on the adequacy of an entity’s risk management objectives?

TransCanada’s Risk Management response:

TransCanada does not believe that every individual risk management activity can be articulated and presented in the financial statements. Nevertheless, in our opinion the IASB proposal, with its comprehensive expansion of its framework to encompass more sophisticated and dynamic hedge strategies, is a step in the right direction for providing useful information regarding risk management.

TransCanada strongly supports a principle-based approach to hedge accounting, including a proposal that grants added flexibility in applying and aligning hedge accounting with risk management. TransCanada supports a hedging objective that allows an entity to accept some additional ineffectiveness in a hedging relationship (hedging instrument chosen that may be operationally simpler to monitor and document and/or cost-effective) that previously would not be designated in a hedging relationship due to the existing ‘bright lines’ requirements. To mitigate confusion and unnecessary complexity, TransCanada proposes that additional clarity be included around the terms ‘risk management strategy’ and ‘risk management objective’ in the proposal. Without clarification these terms could be interpreted to permit discretionary discontinuation of a hedge relationship.

In our view, the IASB Exposure Draft does not provide enough clarity on the appropriate level of documentation required for hedge accounting. Risk management is complex, requires
significant judgment and needs to be flexible to adjust to changing conditions. As such, documentation for hedge accounting must incorporate and support dynamic risk management strategies. The IASB proposal will have a significant impact of current risk management policies and hedge documentation. Complications may arise for preparers when documenting hedging relationships in linking the individual hedging transactions at the lowest level to the entity wide risk management objectives. As a result, auditing an entity’s assertions that it has adequately aligned its hedging relationships with its risk management activities may be difficult. In addition, would the auditor have the necessary experience and expertise internally which would be required to audit the adequacy of an entity’s risk management objectives?

**Hedging Instruments**

**Question 5:** Should cash instruments be eligible to be designated as hedging instruments? Why or why not? If yes, is there sufficient rigor to prevent an entity from circumventing the classification and measurement guidance in other relevant accounting guidance (for example, IFRS 9, *Financial Instruments*, and IAS 21, *The Effects of Changes in Foreign Exchange Rates*)? Are there any operational concerns about designating cash instruments (such as items within a portfolio of receivables) as hedging instruments?

TransCanada has no comment on this question.

**Hedged Items – Overall**

**Question 6:** Do you believe that the proposed guidance is sufficient to understand what constraints apply when determining whether an item in its entirety or a component thereof is eligible to be designated as a hedged item (for example, equity instruments measured at fair value through profit or loss, standalone derivatives, hybrid instruments, and components of instruments measured at fair value through profit or loss that are not permitted to be bifurcated)? If not, what additional guidance should be provided?

TransCanada has no comment on this question.

**Hedged Items – Risk Components**

**Question 7:** Do you believe that the proposed criteria are appropriate when designating a component of an item as a hedged item? If not, what criteria do you suggest? Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to determine when the criteria of separately identifiable and reliably measurable have been met? If not, please describe what additional guidance should be provided.

**Question 8:** Do you believe that “separately identifiable” should be limited to risk components that are contractually specified? Why or why not?
APPENDIX – Response to the Invitation to Comment on Selected Issues about Hedge Accounting

TransCanada's Risk Components response:

TransCanada supports the IASB's approach of not limiting the eligibility of a risk component for designation as a hedge for financial and non-financial instruments to align the actual operational hedging strategies of an entity. Although TransCanada believes the proposed criteria of separately identifiable and reliably measurable are appropriate we would suggest additional guidance to enhance the consistent interpretation of these principles as they are key in determining the eligibility of risk components as hedged items.

The risk component proposal is particularly relevant for the utility industry since the products (i.e. electricity or gas) to be delivered at a specific location are typically made up of two components. The two components are the commodity price at a liquid location (hub) and the differential in price between the hub location and the actual delivery point (basis). Under current US GAAP and IAS 39, each of the components on their own do not effectively offset the cash flow variability of the forecasted transaction at its actual delivery point. To correctly portray the actual risk management activities of an entity the standard should not be limited to contractually specified risk components to allow hedge accounting for different components as described in the example above.

Hedged Items – Layer Component

**Question 10:** Do you believe that the proposed guidance is sufficient to understand what constraints apply to determining a layer component from a defined, but open, population? (For example, do you believe that the sale of the last 10,000 widgets sold during a specified period could be designated a layer component in a cash flow hedge?) If not, what additional guidance should be provided?

TransCanada supports an entity's ability to designate a layer of the nominal amount of an item as the hedged item as it links hedge accounting to risk management. TransCanada believes that any portion of a hedged item that is separately identifiable and reliably measurable should qualify for designation as a hedged item. The example in the IASB Exposure Draft paragraph B21(b) regarding a layer of gas stored requires additional guidance as the separately identifiable criteria (timing of the sale or use of the gas) may be difficult to sufficiently support for audit purposes.

TransCanada believes that the sale of the last 10,000 widgets sold during a specified period could be designated as a layer component in a cash flow hedge. Paragraph B65 of the IASB Exposure Draft explains that there can be uncertainty surrounding the amount or timing of the hedged item and this uncertainty does not affect the hedging relationship to the extent that the hedged volume occurs (irrespective of which particular individual items make up that volume). As a result, TransCanada believes that the bottom layer is no different from any other layer component of a nominal amount and therefore could be designated as a layer component.
APPENDIX – Response to the Invitation to Comment on Selected Issues about Hedge Accounting

Hedged Items – Aggregated Exposures and Groups of Items

Question 11: Do you foresee any operational concerns applying other guidance in IFRS (for example, guidance on impairment, income recognition, or derecognition) to those aggregated positions being hedged? For example, do you foresee any operational concerns arising when an impairment of individual items within a group being hedged occurs? If yes, what concerns do you foresee and how would you alleviate them?

TransCanada has no comment on this question.

Question 12: Do you believe that the proposed guidance on aggregated exposures will provide more transparent and consistent information about an entity’s use of derivatives? Why or why not?

TransCanada has no comment on this question.

Question 13: Do you believe that an entity should be permitted to apply hedge accounting to a group of cash instruments or portions thereof that offset and qualify as a group under the proposed guidance and satisfy the proposed hedge effectiveness criteria? Why or why not?

TransCanada has no comment on this question.

Hedge Effectiveness

Question 14: Do you foresee any significant operational concerns, including auditing issues, in determining how to assess whether a hedge achieves other-than-accidental offset? If yes, what concerns do you foresee and how would you alleviate them?

TransCanada generally agrees with the proposed hedge effectiveness criteria in paragraph 19 of the IASB Exposure Draft. However, it is unclear how an entity would align its risk management objective, which may be done at a high level of an entity’s structure, with individual hedging relationship and evaluate whether it meets the conditions of minimizing expected hedge ineffectiveness and produces an unbiased result. Within the IASB Exposure Draft there are a number of instances where management judgment will need to be applied. These include whether an effectiveness assessment needs to be performed between two reporting dates and if there is a need to rebalance. This may mean two entities with the same risk management strategy could report different hedge accounting results. As a result, auditing whether a hedge relationship is effective could be challenging.

The IASB Exposure Draft is unclear as to whether an entity is permitted to use a hedging instrument that does not provide the best possible offset to the hedged item and therefore the least amount of ineffectiveness. In some instances, particularly in non-financial hedging relationships, the instrument that provides the best offset is not always available due to market illiquidity and/or cost limitations. TransCanada would suggest that a better approach may be to permit entities to use the hedging instrument that aligns with their risk management policies, but also meets business objectives such as cost effectiveness, regardless of whether the instrument
APPENDIX – Response to the Invitation to Comment on Selected Issues about Hedge Accounting

provides the best possible offset to the hedged item. Therefore, TransCanada believes that the criteria in IASB Exposure Draft paragraph 19c(i) and B29 should be amended to instead focus on whether an appropriate economic relationship between the hedging instrument and the hedged item exists that meets the risk management objective.

**Question 15:** Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to analyze hedge effectiveness (for example, how to measure the change in the value of the hedged item attributable to the related hedged risk for nonfinancial items)? If not, what additional guidance is needed?

The IASB Exposure Draft focuses on using a hedge ratio to minimize expected ineffectiveness but does not specify a method for assessing whether a hedging relationship meets the hedge effectiveness requirements, including determination of the hedge ratio. Although TransCanada agrees that an entity needs to use a method that captures the relevant characteristics of the hedging relationship as specified in the risk management objective, we feel that additional guidance and examples should be provided in the IASB Exposure Draft, particularly for non-financial hedging relationships where critical terms are not necessarily closely aligned and the hedge ratio is other than 1:1. As stated in our risk management response above, complications may arise for preparers in linking the individual hedging transactions at the lowest level to the entity wide risk management objectives including what level to apply the hedge ratio. Difficulties may arise in the application of the hedge ratio concept including management tolerance levels for changes in quantitative inputs (i.e. regression results) used to determine the hedge ratio.

Furthermore, TransCanada believes that quantitative hedge effectiveness assessment should be tested at inception and subsequently only when there is a change in circumstances. As hedge accounting would be aligned with risk management objectives, qualitative analysis at each reporting date should be sufficient in assessing hedge effectiveness.

**Changes to a Hedging Relationship**

**Question 16:** Do you foresee any significant operational concerns or constraints in determining whether (a) a change to a hedging relationship represents a rebalancing versus a discontinuation of the hedging relationship or (b) an entity’s risk management objective has changed? If yes, what concerns or constraints do you foresee and how would you alleviate them?

The IASB Exposure Draft implies that an entity can rebalance at a date other than the reporting period if there is a significant change in circumstance affecting the hedge effectiveness requirements. It would be useful if additional clarification is provided on what constitutes a significant change in circumstance affecting the hedge effectiveness requirements. For example, would increased price volatility in a commodity market be a significant change? Under current standards, increased volatility may result in failed regressions, which would require a discontinuation of specific hedging relationships. Would weakened regressions always require a change in the hedge ratio and therefore rebalancing? TransCanada has interpreted the IASB Exposure Draft such that hedge accounting can continue as long as the risk management objective is unchanged and the weakening of the regression is not a permanent change (i.e.
APPENDIX – Response to the Invitation to Comment on Selected Issues about Hedge Accounting

normal fluctuations) to the hedging relationship and therefore no change would be made to the hedge ratio and rebalancing would not be necessary. A further consideration is whether auditors would accept continued hedge treatment in a scenario where regressions showed that correlations have weakened, but the entity’s risk management objectives are still being met by the hedge relationship.

Question 17: Do you foresee any significant operational concerns or constraints relating to the potential need to rebalance the hedging relationship to continue to qualify for hedge accounting? If yes, what concerns or constraints do you foresee and how would you alleviate them?

TransCanada believes that there would be significant challenges for the preparers on when and how to rebalance. Auditors may also be challenged in independently verifying the result. A new operational challenge has been created by the IASB Exposure Draft for those companies that have numerous hedge relationships by replacing the 80%-125% test with the requirement to ensure there is no bias in the hedging relationship. From a practical prospective, currently companies with numerous hedging relationships can rely on automated processes to determine whether a mathematical calculation is within a boundary of 80%-125%. Under the proposal, significant judgment would be required to ensure whether each hedge relationship is unbiased and whether rebalancing is necessary.

The IASB Exposure Draft requirement to ‘eliminate any bias’ indicates an expectation that no bias is acceptable. TransCanada recommends that judgment be permitted in deciding whether to rebalance, not solely based on the sources of ineffectiveness and whether the additional ineffectiveness is a trend, but also on the degree of tolerance in expected bias that is acceptable over the life of the hedge. Furthermore, requiring rebalancing of a hedging relationship may cause entities to determine a different hedge ratio for accounting purposes than they are using for risk management purposes. Therefore, to avoid rebalancing for accounting purposes, TransCanada believes rebalancing should be done only when the entity’s risk management takes action to change the hedging relationship.

Accounting for the Time Value of Options

Question 18: Do you believe that capitalizing the time value of an option as a basis adjustment of nonfinancial items (in other words, marking the asset or liability away from market) will improve the information that is provided in an entity’s statement of financial position? Why or why not?

TransCanada has no comment on this question.

Hedge Accounting and Presentation

Question 19: Do you believe that the proposed presentation of the gains and losses in other comprehensive income will provide users of financial statements with more useful information? Why or why not?
APPENDIX – Response to the Invitation to Comment on Selected Issues about Hedge Accounting

TransCanada believes that the gains and losses should be included in the note disclosure rather than adding detail and ‘clutter’ to the primary financial statements. As an alternative, providing this information on the statement of financial position could be optional if an entity believes that this information would be significant and useful to the readers.

**Question 20:** Do you believe that the proposed presentation of a separate line item in the statement of financial position would increase the transparency and the usefulness of the information about an entity’s hedging activities? Why or why not?

See TransCanada’s comment to question 19.

**Question 21:** Do you believe that there is sufficient guidance to specifically link the hedging adjustments to the hedged assets and liabilities that compose a hedged net position with respect to presenting a separate line item in the statement of financial position?

TransCanada has no comment on this question.

**Disclosures**

**Question 22:** Do you foresee any significant auditing issues arising from the inclusion of risk management disclosures in the notes to the financial statements? If yes, what issues do you foresee and how would you alleviate them? Do you believe that it is appropriate to include risk management disclosures in the notes to the financial statements rather than in other information in documents containing financial statements? Why or why not?

TransCanada is concerned that certain disclosure in the Exposure Draft appears excessive and does not strike the right balance between the needs of the financial statement users and the burden to the financial statement preparers. Disclosure required in paragraph 46 of the IASB Exposure Draft in some instances is commercially sensitive information and may influence a company’s decision to apply hedge accounting. TransCanada feels that financial statement users are already overloaded with the complexity of risk management and hedge information. A standard that focuses on the qualitative aspects of paragraph 46 would provide more meaningful information for users and would lessen the burden on preparers.

**Other**

**Question 23:** Do you believe that the changes proposed by the IASB provide a superior starting point for any changes to U.S. GAAP as it relates to derivatives and hedging activities? Why or why not? Should the FASB be making targeted changes to U.S. GAAP or moving toward converging its overall standards on derivatives and hedging activities with the IASB’s standards?
APPENDIX – Response to the Invitation to Comment on Selected Issues about
Hedge Accounting

TransCanada strongly supports convergence of IFRS with US GAAP in its overall standards on derivatives and hedging activities to enable comparability of financial information between companies.

Alternatively, if FASB elects not to converge standards with the IASB, specific issues where TransCanada would prefer to see targeted changes to US GAAP are as follows:

- Allowing a non-financial risk component to be separately hedged,
- Allowing a post-rebalanced hedge to continue as part of the same hedge relationship,
- Permitting voluntary termination of hedge accounting, and
- Removing the proposal for recording ineffectiveness for ‘under-hedges’ (whereby the effective portion of the derivative’s fair value change is less than the hedged item’s fair value change).

TransCanada prefers the IASB approach which comprehensively expands its framework to encompass more sophisticated and dynamic hedge strategies, and also aligns accounting with risk management activities. However, as noted in our cover letter and throughout this document, we believe there are clarifications needed within the IASB Exposure Drafts. The FASB and IASB proposals will have a pervasive impact to current hedge accounting which will significantly impact preparers. Accordingly, the proposals should be subject to field testing to ensure that a final standard on hedge accounting can be applied in practice and the costs to preparers are worth the benefits to users.