October 13, 2016

Financial Accounting Standards Board
Technical Director
File Reference No. 2016-290
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116
United States

Dear Sir/Madam:

Re: Comments on the Board’s Agenda Consultation

Hydro-Québec is a major North American producer, transmission provider and distributor of electricity, operating mainly in the province of Québec, Canada. Its sole shareholder is the Québec government. In Québec, the transmission and distribution of electricity are regulated by the Régie de l’énergie, which sets rates on the basis of cost of service plus a reasonable return on the rate base.

On behalf of Hydro-Québec, I thank you for giving us the opportunity to comment on the Board’s document entitled Agenda Consultation.

Attached are our detailed responses to the questions in the invitation to comment.

Should you wish to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Lise Croteau, FCPA, FCA
Executive Vice President and Chief Financial Officer

Encl.
General

**Question 0.1:** Are there major financial reporting issues that are not considered in this ITC that should be addressed by the FASB before any of the issues discussed in the ITC are addressed? What are the considerations or criteria that you used to identify these issues? Please describe any of those issues and your perspective about how the FASB should resolve the issues.

We consider the issues identified in our answer to Question 0.2 as being a priority.

We have identified the following issues that have not been sufficiently dealt with by the current standards and should be subsequently addressed by the FASB:

1) Service concession agreements: accounting treatment to be adopted in cases not concerning financial assets;
2) Renewable energy integration service agreements, such as wind energy and energy transfer agreements; and
3) REC (renewable energy certificates, renewable energy attributes, energy credits, green tags).

These issues have been identified based on the situations experienced in which standards do not indicate how they should be treated in the financial statements.

**Question 0.2:** What is your view about the priority of addressing the major financial reporting issues addressed in this ITC? In other words, is addressing one or more of the issues more critical than others? Please describe your assessment criteria and why you prioritized certain issues above others.

We consider that intangible assets related to R&D costs should be prioritized by the FASB, given the significance of the amounts in financial statements related to this subject.

**Question 0.3:** Is it necessary to resolve one or more of the issues before resolving others? In other words, is the resolution of any of the issues dependent upon the resolution of one or more other issues? Please identify any of the projects that should be completed before others and why.

The employee future benefits project depends on the orientations concerning comprehensive income. If you intend to make changes in accounting for comprehensive income, these changes should be taken into account in the employee future benefits project.
Intangible Assets (including Research and Development)

Question 1.1: Is the accounting for intangible assets (including research and development) a major financial reporting issue that the FASB should consider for improvement? Please explain why.

We are of the opinion that accounting for intangible assets is an issue that should be analyzed because certain intangible assets that are not accounted for may represent a significant value.

Question 1.2: If yes, should the issue be addressed broadly for all intangible assets or should it first be addressed for a subset of intangibles (for example, research and development)? Please explain why.

We think that the improvement project should first address accounting for research and development expenses given that this type of expense accounts for a considerable share of the costs incurred to develop a number of internally generated assets.

Question 1.3: Which approach to addressing the issue is appropriate, considering the benefits and costs of each approach and why? If you recommend a recognition approach, please explain your view about (a) the threshold for recognizing the asset and (b) the measurement of the asset (cost or fair value). If you recommend a disclosure approach, please explain the disclosure objective and recommend what specific information should be disclosed. If you recommend an approach to adopt IAS 38, please explain any implementation concerns.

We are of the view that the improvement project should focus on analyzing the recognition approach for intangible assets, and more specifically, research and development costs, as accounting for these costs is the main difference between IFRS and U.S. GAAP. We also think that the capitalization threshold should be determined on the basis of the capitalization criteria prescribed by IAS 38. Finally, we consider that the measurement basis should be at cost given the insufficient amount of observable and objective data concerning this type of asset on the market, and in order to be consistent with the standards currently in effect for accounting for long-term intangible assets (internally generated software, direct advertising expenses), which are recognized at cost and not at fair value. In addition, the adoption of a recognition basis at cost would converge with IAS 38, which we would favor in the case of R&D costs.

Question 1.4: Recognition of an intangible asset if a threshold is met and measurement of that asset at fair value would likely result in (a) a gain in the period in which the asset initially is recognized and (b) gains or losses in each period for the change in the fair value of the asset. How should those initial and subsequent gains and losses be presented in the income statement?

Since we consider that the measurement basis should be at cost and considering that Section 4 of this document challenges the relevance of reclassifications from the consolidated statement of comprehensive income to the income statement, we will not issue any opinion on this question.
Pensions and Other Postretirement Benefit Plans

Question 2.1: Is the accounting for pensions and other postretirement benefit plans a major financial reporting issue that the FASB should consider for improvement? Please explain why.

We do not think that the current accounting for defined benefit pension plans should be amended substantially.

Issue 1—Delayed Recognition (Smoothing) in Earnings

Question 2.2: Would Alternative A (see paragraphs 2.15–2.16) and/or Alternative B (see paragraphs 2.17–2.19) improve the usefulness of financial information provided to users and be operable?

Alternative A

Convergence with IFRS would reduce the difference between the two frameworks. However, we do not support converging with IFRS. As for defined benefit plans, we are not in favor of never recycling actuarial gains and losses in earnings. Part of these gains and losses are realized as obligations are settled through benefit payments to beneficiaries, for instance, and amortization of actuarial gains and losses could be used to reflect this fact, although calculating the amounts of realized gains and losses is complex. Calculation of the amortization could perhaps be reviewed, but this is a matter to be discussed with actuaries.

In addition, calculating net interest does not take into account the long-term return that can be generated by assets. This is a simple calculation, but the result is far from exact.

We are of the view that never recycling actuarial gains and losses in earnings would not yield useful information about the cost of employee future benefit plans. For example, the assumptions made in determining the value of obligations would be different from actual results, and such differences could add up to significant costs (or credits) in the long term. If these changes remain within comprehensive income, the “true” cost of the plans will not be accounted for in earnings.

Alternative B

We also do not think that it is warranted to account for actuarial gains or losses directly in earnings. This would make earnings too volatile if, in particular, a large portion of the actuarial gains and losses are not realized. These plans are the subject of a number of assumptions that are sometimes affected by current market conditions, including low interest rates. Recognizing these variations directly in earnings would not be useful for the users of financial statements, because forward-looking information on the company’s future earnings then could not be provided. What we are trying to measure is the cost of the plan as employees perform their services.

Question 2.3: If you support Alternative A (convergence with IAS 19), would you recommend any modifications to IAS 19 or would you expect any implementation issues? Please explain why.

A full retrospective application would lead to high costs to have actuaries perform the required measurements and for companies to historically restate any costs capitalized to assets such as property, plant and equipment. If Alternative A is selected, a provision should be introduced concerning the implementation date, which should be set at the beginning of the comparative fiscal year presented with the financial statements as of which the change applies. Another provision should be included to allow companies not to historically restate costs capitalized to assets.
**Question 2.4:** Are there other approaches to consider for addressing the issue of delayed recognition in earnings? If so, please provide them in sufficient detail so that the FASB can consider your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

For funded defined benefit plans, we think that the current method is adequate. This type of plan is built over the long term, and excessive variability in earnings can be avoided by using the corridor method in particular. In order to avoid the various methods used, amortization should be applied, but it should be monitored more than it currently is.

**Issue 2—Measurement of Defined Benefit Obligation**

**Question 2.5:** Is the current measurement of a defined benefit obligation appropriate? If not, what changes do you suggest and why (for example, what characteristics of plans are not adequately reflected in the current measurement of the benefit obligation)?

In determining the discount rate, “A” rated bonds should be taken into account more. In fact, the quality of securities rated “A” today is equivalent to the quality of securities rated “AA” 30 years ago. Moreover, the number of bonds rated “AA”/“AAA” is declining.

**Potential Path Forward**

**Question 2.6:** What approach (that is, targeted improvements or comprehensive reassessment) would you recommend and why?

We recommend targeted changes because we consider the current basic recognition adequate.

**Question 2.7:** Are there other issues for pension and other postretirement benefit plan accounting that should be considered for improvement?

We would like to reiterate the fact that we do not support the idea of separating the net cost recognized in earnings based on each of its components.

In our view, a defined benefit pension plan is globally managed and net benefit cost is the cost to provide such a plan to employees. In the long term, the real cost of the plan is made up of all its components.

The FASB objective is to increase the transparency of net benefit cost and provide financial statement users with additional disaggregated information to facilitate their analyses. This information is already provided in the notes to the financial statements. We do not think that a different presentation will enhance transparency.

We are of the opinion that preparers should be allowed to present net benefit cost in operating expenses and disclose in the notes where the cost is presented in the income statement.
Distinguishing Liabilities from Equity

As a Québec government corporation, Hydro-Québec does not issue new common shares. As a result, we have decided not to answer the questions in this chapter.
Reporting Performance and Cash Flows

Income Statement

Question 4.1: Is income statement presentation a major financial reporting issue that the FASB should consider for improvement? Please explain why. In making your assessment, what criteria were used?

We do not consider this to be a major issue. The information produced in accordance with current standards meets the needs of the users of our financial statements.

Question 4.2: How should the components of net income be categorized, if at all? If the FASB were to develop an operating activities category and display a subtotal for operating income, how should the category be defined or described?

We currently present a subtotal for operating income in our consolidated statements of operations. We do not think that it is necessary to have a requirement issued in this regard.

If the FASB requires the presentation of operating income, we think that Alternative A should be used (see our answers to questions 4.3 and 4.4).

Question 4.3: Could an operating activity category be defined or described consistently and effectively for all types of reporting entities (for example, entities involved in financial services, investing, banking, and financing)?

We consider that there should be management determination of an operating activity. As stated in paragraph 4.17 of the Agenda Consultation, the FASB found it difficult to define the operating activities.

Question 4.4: How should the FASB evaluate the benefits of a standardized definition versus a management determination of an entity’s operating activities?

The FASB must determine if a standardized definition of operating activities will allow users to be better informed and if a useful definition can be found in practice.

The management approach has the benefit of informing users of the way management runs an entity and makes decisions, but its consequences are the lack of comparability across entities in the same industry and the costs incurred for the reclassification of information, as strategies may change over time.
Question 4.5: Which, if any, of the three alternatives described for combining or separating items provides more useful information to users of financial statements, and why?

We do not agree that the disaggregation by function, nature or both provides more decision-useful information. The primary objective of the statement of income is to measure the return on investment obtained by an entity during a reporting period. We believe that the presentation requirements for financial statements and related notes are sufficient for a user to make an investment decision.

The note on reportable segments already discloses information by function. A similar presentation in the statement of income is considered redundant. A different presentation in the income statement would result in confusion.

We think that Alternative A would provide more useful information for users of financial statements. Infrequent events should be presented separately in the income statement for a better comparison from one period to the next and to assess financial performance.

Question 4.6: Are there other alternatives for presenting lines within the income statement that the FASB should consider?

We do not have other alternatives to propose.
Segment Reporting

**Question 4.7:** Is segment disclosure a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

In our point of view, segment disclosure is not a major financial reporting issue. However, as mentioned in the *Agenda Consultation*, some aspects can be improved.

**Question 4.8:** Considering the three alternatives described for improving aspects of the Topic 280 disclosure requirements, which, if any, alternative provides more useful information to the users of financial statements and why?

We believe that Alternative A provides the most useful information, i.e. the information reviewed by the chief operating decision maker (CODM), without making tables too cumbersome with boxes having nil amounts.

We are of the opinion that Alternatives B and C, which require “nil” amounts to be indicated for items that have not been reviewed by the CODM, could lead to confusion. For instance, it will be hard for companies to indicate “nil” amounts for some items that are reviewed by a level subordinate to the CODM.

**Question 4.9:** Would the described improvements to (a) reexamine the aggregation criteria and (b) apply the segment standard from a governance perspective provide more useful information to users of financial statements and why?

We think it is pertinent to re-examine the aggregation criteria because they are not sufficiently precise. However, there should not be any strict criteria. The essentials must be kept, namely the sectors must be those reviewed by the CODM.

Furthermore, we believe that the information provided to the Board of Directors is the most decision-useful information for users of financial statements.

**Question 4.10:** Are there other alternatives for improving segment reporting that the FASB should consider? If so, please provide them in detail to help the FASB in considering your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

We do not have other alternatives to propose.
Other Comprehensive Income

Question 4.11: Is the presentation of other comprehensive income a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

We do not consider that it is a major issue. The information provided in accordance with current standards meets the needs of the users of our financial statements. Any change in accounting for comprehensive income could have an impact on the measurement of regulatory assets or liabilities that we have recognized. Consequently, before proposing a change, tariff regulation must be taken into account.

Question 4.12: Considering the two alternatives described for minimizing the use of reclassification adjustments, which alternative provides more useful information to the users of financial statements and why?

We consider that it is more appropriate to reconsider all components of comprehensive income as part of the same project, namely Alternative A. For the purposes of comparability across standards, they should all be reviewed at the same time. According to Alternative B, it could take several years before the components were reviewed and it would be under several separate projects.

Question 4.13: Do the described improvements to (a) remove the option for presenting comprehensive income over two statements and (b) emphasize other earnings per share measures improve the relevance of the performance information included in other comprehensive income?

We prefer to keep the choice between a single statement or two separate but consecutive statements.

We are of the opinion that each statement has a different role. The statement of net income presents an entity’s return, which measures its management efforts and its ability to use its resources in an optimal manner. This information, which is largely known, generally meets the needs of users of financial statements, who use it, in particular, in a number of ratios, some of which can have a specific impact on the entity’s cost of credit, for instance, or on the amount of dividends to be paid. We therefore agree with the principle of preserving the integrity of net income.

Comprehensive income also has its own purpose, since it has become a necessity in view of the balance sheet’s increased importance. Over the past few years, accounting standards have favored a fair balance sheet to the detriment of net income. With comprehensive income and accumulated other comprehensive income, it is now possible to give meaning to the balance sheet as well as to net income.

Finally, with regard to the issues mentioned in the FASB Agenda Consultation, we are of the opinion that it is better to define the role of the statement of comprehensive income and accumulated other comprehensive income, and to establish concepts for the items covered than to target an amalgam of two statements.

As for other earnings per share calculations, we do not have an opinion on the subject because, as a Québec government corporation, we do not calculate performance per share.
Question 4.14: Are there other alternatives for improving the relevance of other comprehensive income that the FASB should consider? If so, please describe them in detail to help the FASB in considering your proposal(s). Please provide your rationale for why your proposal provides users of financial statements with more useful information.

We do not have other alternatives to propose.
Statement of Cash Flows

Question 4.15: Is the presentation of cash flows a major financial reporting issue that the FASB should consider for improvement? In making your assessment, what criteria were used?

We do not consider that it is a major issue. The information provided in accordance with the current standards meets the needs of the users of our financial statements.

Question 4.16: Do you recommend that the FASB retain or reconsider the three-category structure and the definitions of operating, investing, and financing activities within the statement of cash flows?

We recommend that the FASB keep the current structure of the statement of cash flows and allow presentation according to the indirect method. Restructuring the statement of cash flows or mandating the use of the direct method would result in major costs for companies. It would imply modifying systems used to process sales, purchases, payroll and pension benefits. Other one-time implementation costs would include the training of the accounting personnel and changes to financial reporting.

For instance, separating maintenance expenditure from expansionary expenditure for investments in property, plant and equipment in the statement of cash flows would require major changes in information systems. We consider that the current presentation of the statement of cash flows provides sufficient information to users about the nature of our investments in property, plant and equipment.

Under Alternative A, a fourth category would be created, i.e., a residual category. It would not have any theoretical basis and would be difficult to explain to users of financial statements.

Under Alternative B, the comparability of statements of cash flows would be reduced across companies because the categories would be different depending on each company’s internal assessment. In addition, for some large corporations with several separate subsidiaries that each has its own way of functioning, this approach could be difficult to apply when consolidating subsidiaries’ data into a single statement of cash flows. Finally, ongoing application costs would be incurred if an entity changed its measurement of cash flows. The management approach may evolve with management’s strategies over time as well as with external circumstances.

Under Alternative C, we consider that the costs incurred to capture the changes in cash flows, line by line, in the income statement would not add significant marginal information for users of financial statements. The proposed reconciliation is too detailed to be understood by users and could lead to confusion. The cost of preparing the proposed reconciliation outweighs the benefits that a user could obtain from this statement. We consider that the current reconciliation category of “operations” is adequate.

These approaches are very different from the one used today and would require providing a great deal of information to financial statements users so that they could understand the changes.

Significant changes to ASC 230, Statement of Cash Flows, would also make it difficult to compare financial statements across entities in the same industry using IFRS.

Therefore, we consider the current structure of the statement of cash flows adequate and useful for users of financial statements.