



October 6, 2010

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

**Re: Proposed Accounting Standards Update of Topic 825 and Topic 815,
“Accounting for Financial Instruments and Revisions to the Accounting for
Derivative Instruments and Hedging Activities.” File Reference No. 1810-100**

Dear Mr. Golden:

The Association for Financial Professionals (AFP) appreciates the opportunity to comment on the Exposure Draft of the proposed Accounting Standards Update of Topic 825 and Topic 815 titled, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*, issued May 26, 2010 (the “ED”). AFP represents approximately 16,000 finance and treasury professionals from over 5,000 corporations, including the Fortune 1,000 and the largest of the middle market companies. Our membership includes a significant number of corporate treasurers who are responsible for the protection and management of corporate cash, cash flow requirements and corporate investments; in addition to controllers and CFOs who are responsible for their corporate accounting, financial reporting and regulatory compliance.

AFP members understand and support FASB’s efforts to provide financial statement users with a more timely and representative depiction of an entity’s involvement in financial instruments, while simultaneously reducing the complexity in accounting for those instruments. They also understand the importance of providing the most useful, transparent, and relevant information to investors about the financial assets and financial liabilities of a reporting entity. However, they have expressed some concerns to us that we wish to share with you on this proposed guidance.

Loss of Shortcut Method

The ED proposes the elimination of the “shortcut method” and the “critical terms match method” preferred by many of our members that use plain vanilla instruments to mitigate exposure from interest rate risk. Our members have embraced using the shortcut method, particularly for fair value hedges, because it afforded the opportunity to avoid the onerous task of calculating the fair value of debt using complex methodologies, most of which have evolved through practice since

ASC topic 815 provides limited guidance on this. Corporations are not using interest rate swaps to hedge the fair value of their debt but in fact use them to manage interest rate risk, converting fixed coupons to floating or vice versa. The shortcut method allows them to assume that a hedging relationship is highly effective and recognize no ineffectiveness in net income during the term of a hedge relationship. More importantly, it significantly simplified the assessment and measurement for hedge relationships that were obviously effective.

Measurement Concerns

AFP members understand your rationale for why the shortcut exception is no longer necessary. However, it will require companies that currently use the shortcut method to develop long-haul measurement methodologies. The current long-haul methodologies for fair value hedges create ineffectiveness and complexity for a variety of reasons, including (a) debt that trades at significantly over or under par at hedge designation, and (b) credit spreads implicit in the debt coupon. A swap used as a hedging instrument does not have an offsetting “pull to par” effect exhibited in the debt and has no significant credit spread implicit in the cash flows. These and other complexities cause most companies that use long-haul to utilize outside vendors or time consuming and costly analysis to measure ineffectiveness. Given that only the risk-free rate portion of the fair value change is being hedged, our members suggest consideration of one of the following, less complex approaches to measurement for the debt when a fair value hedge is used:

1. ASC 815-25-35-13 precludes the bifurcation of the debt coupon between the risk-free rate and credit spread. IAS 39, as currently written, allows for much more flexibility. If the risk free rate portion of the coupon were bifurcated for fair value measurement, this would largely eliminate the issues identified in (a) and (b) above.
2. Allow a hypothetical derivative model (a receive floating, pay fixed swap) to be used as a proxy for the debt value. Such derivative would have critical terms that match the debt instrument and would align with existing guidance in paragraph 122 of the ED for measuring ineffectiveness in a cash flow hedge.

Assessment Concerns

If the Board chooses not to simplify the measurement methodologies for fair value hedges, our members urge you to consider adding more examples of when it is reasonable for a preparer to expect that, at inception, a fair value hedge of fixed rate debt would be expected to be reasonably effective when significant credit spreads exist and/or the debt trades at well above or below par. If complex measurement methodologies are used that produce ineffectiveness, many times not reflecting the true risk being hedged (i.e., the risk free rate), it could call into question a company’s original conclusion that a relationship was expected to be reasonably effective.

Fair Value of Money Market Funds (Question 6)

AFP members issue commercial paper to meet short-term financing needs such as funding payroll, replenishing inventories, and financial expansions. Since the mid-1980s money market

funds have been major, reliable buyers of those securities and today purchase over 40 percent of the commercial paper issued by American businesses. Recently, these funds have come under scrutiny by the SEC, which is reportedly considering the elimination of the stable net asset value (NAV). If the funds will have to report on them at fair value, investors and issuers will be impacted. The end result is that there would likely be less of a market for commercial paper. Some investors will be forced to walk away due to mandatory investment guidelines that require a stable per share value. Others will choose to move their funds elsewhere after the simplicity and convenience of the stable NAV disappears.

This situation is further complicated by your requirement that money market funds that comply with Rule 2a-7 of the SEC's Investment Company Act of 1940 measure their investments at fair value rather than at amortized costs.

AFP members believe that the FASB should clarify what measurement is required for non money market fund entities who invest in money market funds. Clarification also is needed regarding whether this accounting standard is meant to clarify or supersede the SEC's regulatory guidance on reporting 2a-7 funds.

Topic 820-10-20 defines the fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (based on the exit price).

It is our presumption for a holder that this price would be the equivalent of the \$1 per share value or amortized cost of the instrument. However, there may be confusion derived from the SEC's recent requirement to also disclose the "shadow" net asset value of the funds, even if the redemption price remains fixed at \$1 per share. While generally, the two values will remain the same, there could be times when the values are slightly different. As a result, the question of which value is the appropriate fair value might surface. It is also worth mentioning that the shadow net asset value required under the SEC's rulemaking is reported on a lag from the financial reporting date and thus, may not reflect the true fair value at the date of financial statement issuance. Therefore, we ask that you provide more clarity around this issue should you choose to move forward with requiring the fair value rather than the value at amortized cost. We also ask that you clarify whether the fair value measurement is required for the issuer, the holder or both.

Holding for Contractual Cash Flows (Question 31)

AFP members do not support the proposed accounting measurement (fair value through other comprehensive income, "FV-OCI") for financial assets meeting the criteria in paragraph 21. Our members believe that such instruments should be accounted for at amortized cost. However, given the magnitude of other comment letters on this topic, we will avoid further discussion of that issue.

AFP members generally support the requirement of paragraph 21(b) of the ED for determining when an instrument is not accounted for at fair value through net income ("FV-NI"). That

provision requires that an entity's business strategy be to collect or pay contractual cash flows rather than sell the instrument. Further, paragraph 22 states that the strategy shall be to hold assets "...for a significant portion of their contractual term." In paragraph IG37, the ED states that "...an occasional sale or settlement may occur" without calling into question the strategy of the portfolio. Our members are concerned that this language regarding "occasional sales" may cause some to interpret significant or even moderate sales in such a portfolio to question the qualification for FV-OCI, regardless of the reason for such sales. We suggest that the Board clarify, through example, scenarios where sales would not call into question the strategy qualification for FV-OCI. For example:

- A company holds significant cash reserves as part of an investment portfolio that is used to fund periodic acquisitions. Such acquisitions are sporadic (sometimes 3 or more years apart). The company does not hold significant duration in the portfolio given the possibility of acquisitions, but some duration exists to maximize yield. Between acquisitions, the company has minimal sales activity within the portfolio, but when an acquisition occurs, significant sales occur, at times being nearly the entire portfolio. Our members do not believe that such "event driven" sales should call into question the strategy of holding for contractual cash flows. Our members believe investors are better served if earnings reflect the yield on the securities rather than all changes in fair value given that those changes in fair value are not expected to be realized through sale. Such a conclusion might differ if the duration held in the portfolio significantly exceeded expectations for the next "event."
- A company dynamically manages an investment portfolio to manage risk and/or improve yield by (a) at times selling certain sectors within the portfolio and replacing it with others or (b) changing the duration of the portfolio to manage risk, liquidity profile etc. Our members believe such events should not call into question the intent to hold for contractual cash flows so long as such occurrences do not frequently result in significant portfolio turnover within short periods of time.

AFP members believe that, absent such clarifying examples, practice may evolve such that meeting criterion paragraph 21(b) will become only slightly less restrictive than obtaining "held to maturity" classification under existing guidance. We base this on the fact that FV-NI is the default classification and the belief that auditors will likely conclude that FV-NI is more conservative.

Credit Pool and Day One Losses (Questions 42 & 45)

AFP members do not agree with the conclusion that even if a debt security is deemed individually to have no credit impairment it should be evaluated as part of a pool, particularly if such a pool evaluation results in "day one" losses. Such a requirement is likely to result in day one losses based on a security being part of a pool for which historical defaults exist. Treasury managers frequently buy securities with higher (or even moderate) yields knowing that credit defaults may occur, even if remote. These yields compensate for this risk, but the yield is recognized over the life of the instrument. Accordingly, our members believe that any such anticipated losses should similarly be recognized over the life of the instrument unless

impairment becomes more likely and a specific impairment attributable to that security is identified. Our members understand that the IASB's model would accrue anticipated losses over the instruments life, but our members also believe there are significant practical and operational issues with their model. We strongly encourage the FASB and IASB to collaboratively develop an impairment model that is more operational than the IASB's proposal, but does not require day one loss recognition as would occur under the FASB's model.

Reasonably Effective Defined (Question 56)

AFP members support your decision to ease the effectiveness from highly effective to reasonably effective. This change will certainly reduce the assessment documentation impact. However, our members have concerns with your silence on defining what is reasonably effective.

In one sense, our members understand the need to move from the current rules based accounting standards to more principles based in tandem with International Accounting Standards. However, the reality is that the United States operates in a highly litigious environment. They believe if the FASB does not provide more insight surrounding what is meant by reasonably effective, the decision will not be based upon management's judgment of reasonableness. Rather, the decision will be made via a consensus of the auditing firms. Therefore, in the absence of a bright line range for what is considered "reasonable", we urge you to include some examples for assessing effectiveness in the final issued standard. Those examples should include scenarios where obvious sources of ineffectiveness exist, but can be dismissed based on qualitative factors.

Calculation of ineffectiveness for cash flow hedges (Question 61)

AFP members generally do not support the proposed change in the recognition of ineffectiveness as it relates to cash flow hedge accounting. In paragraph 123, the Board is proposing that ineffectiveness be recognized for both over hedging and under hedging. This change would require the recognition of an unrealized gain/loss on the basis of a forecasted transaction or non existing asset or liability. The recognition of a gain or loss based upon an under hedge would impact earnings without being associated with an asset or liability. The benefit to financial statement users of impacting earnings and OCI based upon under hedging is not clear in this proposal. Thus, we believe that the current rules set forth in ASC 815-30-35-3(b) should remain in place instead of the proposed changes which would impact earning based upon underperformance of a cash flow hedge.

Option Hedging (Question 61)

AFP members believe that the Board's intent in paragraph 125 of the ED should be clarified. Specifically, that section indicates that when a company bases its ineffectiveness measurement on total changes in cash flows (the "G20 approach") that "...it shall reclassify from other comprehensive income to net income each period on rational basis an amount that adjusts net income for the amortization of the cost of the option." Specifically, our members do not believe that the term "rational basis" is clearly defined. For example, would (a) straight line over the

hedging period and (b) at the time the hedged item is recognized in income both be considered “rational.” In place of adding clarity, we believe that existing guidance under DIG G20 should remain and that no change is needed in this area. The issue of time value decay and the appropriate accounting was much more fully vetted when DIG G20 was deliberated. We note that the provisions proposed in paragraph 125 do not result in convergence to IAS 39. If convergence of this issue is not achieved with this project, we strongly encourage the FASB not to change existing practice given that preparers will likely need to change again when adopting IFRS later this decade.

De-Designations (Question 63)

AFP members generally do not support the proposed elimination of the ability to de-designate a hedging relationship. This adds operational complexity with the same result still able to be achieved if the instrument is terminated. A common example of the use of de-designations is the hedge of a forecasted foreign currency (FX) sale on credit. An entity will use an FX forward or option to hedge the sale until the revenue is recognized and a receivable is created. At that point, hedge accounting is no longer necessary as the remeasurement of the FX receivable pursuant to ASC 830 offsets the revaluation of the derivative. In fact, the use of de-designations in this scenario is specifically contemplated by ASC 815-20-25-35 (paragraph 36A of FAS 133). ASC 815-30-35-9 (DIG H15) is a hedge structure that allows for such a scenario to avoid de-designations.

However, as we understand it, this structure is rarely used in practice due to its complexity. Our members believe that requiring an entity to terminate the existing arrangement or comply with the complex accounting required by DIG H15 only increases compliance costs and does not serve the goal of hedge accounting simplification. Regardless, should the FASB retain the preclusion against de-designations, we recommend that any entity be permitted to document in its original hedge documentation that hedges may be discontinued as of a specific event (e.g., realization of revenue). Such language was specifically contemplated in the 2008 ED in the black-line edits to paragraph 168 of FAS 133.

Other Issues

Intercompany Hedging

Prior to the FASB’s issuance of this ED, the 2008 exposure draft on hedge accounting proposed an amendment to FAS 133, paragraph 40, which would have severely limited the use of intercompany hedges by its proposed language as underlined below:

A nonderivative financial instrument shall not be designated as a hedging instrument in a foreign currency cash flow hedge. A derivative instrument designated as hedging the foreign currency exposure to variability in the functional-currency-equivalent cash flows associated with a forecasted transaction (for example, a forecasted export sale to an unaffiliated entity with the price to be denominated in a foreign currency), a recognized asset

or liability, an unrecognized firm commitment, or a forecasted intercompany transaction (for example, a forecasted sale to a foreign subsidiary or a forecasted royalty from a foreign subsidiary) qualifies for hedge accounting if all the following criteria are met. However, the requirement in paragraph 29(c) that the forecasted transaction presents an exposure to variations in cash flows that could affect reported earnings must still be met at the level being reported on. (For example, in the financial statements of a consolidated entity, there would need to be a potential earnings effect that survives consolidation.)

In many cases, this earnings effect would not survive consolidation. Even though a parent company can always enter into an economic hedge with the presumption that the volatility through earnings would not be material, not having the ability to receive the accounting treatment could materially impact the earnings of the subsidiary.

In your summary of comment letters received on the 2008 ED, there appeared to be confusion regarding your intentions when expounding upon this topic. However, you were still silent on this issue in the current ED. We urge you not to move forward with the previous language in the final guidance. Our members use intercompany hedging as a means to mitigate foreign currency risk. If this language is reinserted, companies with revenues and costs in subsidiaries that use local currency as the functional currency will no longer be able to protect themselves with hedge accounting from the earnings exposure that arises from translating those revenues and expenses into USD at rates that differ from expectations. Many have interpreted existing guidance to allow hedging of intercompany payments (e.g., royalties), which are a proxy for this translation exposure.

AFP members support the efforts of the FASB to steward the development of high quality accounting standards. Thank you for the opportunity to comment on this Exposure Draft. Please feel free to contact Salome J. Tinker, AFP's Director of Accounting and Financial Reporting Policy for any additional information and questions at (301) 961-8871 or sltinker@AFPonline.org.

Sincerely,



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Chair of the AFP Financial Accounting and
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Joseph C. Meek,
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