

August 15, 2008

Russell G. Golden, CPA Technical Director FASB 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 78

Re: June 6, 2008 Exposure Draft (ED) of a Proposed Statement of Financial Accounting Standards (SFAS), Accounting for Hedging Activities, an amendment of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities [Project No. 1590-100]

Dear Mr. Golden:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the ED and is providing the following comments for your consideration.

GENERAL COMMENTS

In general, TIC does not support the issuance of this ED and shares the concerns voiced by the dissenting Board members in the Alternative Views section of the ED (paragraphs A52-A60). TIC's primary concerns with the ED relate to:

- The Board's decision that entities would no longer be able to hedge the interest rate risk in their forecasted cash flows unless the hedge was designated at inception. The elimination of the ability for a so-called "late" hedge for interest rate risk will pose significant operational hurdles. TIC believes entities will have difficulty obtaining instruments that can effectively hedge all risks related to cash flows, including their own credit, particularly as applied to privately held entities that have no ratings on their debt.
- The elimination of the shortcut method, which is used predominantly by nonpublic





entities and small public companies.

TIC believes many of the proposed amendments will be detrimental to private companies and will not achieve the FASB's objectives. As a result, TIC believes this amendment should not be finalized. Waiting for international convergence will cause the least disruption for private entities and the users of their financial statements.

If the ED is issued as a final standard, TIC believes the shortcut method or some variation of the shortcut method, such as the critical terms match concept, should be retained for nonpublic entities, and hedges of an entity's interest rate risk on its own debt should be permitted either before or after the debt is issued. If the shortcut method is not retained, TIC requests an illustrative example of the accounting for a typical interest rate swap without bifurcation-of-risk hedge accounting.

Further discussion of the above issues and other comments are included below in TIC's responses to selected questions contained in the Notice for Recipients.

SPECIFIC COMMENTS

Hedged Risk

Issue 1: Omitted

Issue 2: For the reasons stated in paragraphs A18-A20, the Board decided to continue to permit an entity the ability to designate the following individual risks as the hedged risk in a fair value or cash flow hedge: (a) interest rate risk related to its own issued debt (that is, its liability for funds borrowed), if hedged at inception, and (b) foreign currency exchange risk. For those two exceptions, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship.

Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

Yes, TIC believes that an entity should still be able to hedge interest rate risk on its own debt and foreign currency exchange risk. However, TIC believes the requirement that interest rate risk can only be separately designated as a hedged risk at the inception of the loan, is too limiting.

TIC therefore supports the Alternative Views of the Board members (as presented in





paragraphs A57-A58 of the ED) who disagreed with this amendment to SFAS No. 133. They imply that the changes proposed by the Board would disproportionately impact smaller public and nonpublic companies, which frequently enter into a hedge after the issuance of their debt to be responsive to the interest rate environment. They also believe the bifurcation-by-risk approach would not be logical or operational and would add complexity without fixing the problem of hedging an entity's own credit risk, and they express concerns about the timing of this proposal in view of the impending international convergence initiatives and the potential criticism the Board will receive for adopting a "rules-based and complex" standard.

TIC therefore recommends that the Board reconsider the dissenters' views. TIC sees no benefits to financial statement users for this accounting change. In addition, TIC believes no abuses would result from continuing today's practices for hedging interest rate risk on an entity's own debt. Therefore, TIC believes entities should be able to hedge the variability in the cash flows on their own debt due to interest rate risk at any time.

Hedge Effectiveness

Issue 3: This proposed Statement would eliminate the shortcut method and critical terms matching. Therefore, an entity would no longer have the ability upon compliance with strict criteria to assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings during the term of the hedge. As a result, when accounting for the hedging relationship, an entity would be required, in all cases, to independently determine the changes in fair value of the hedged item for fair value hedges and the present value of the cumulative change in expected future cash flows on the hedged transaction.

Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships? Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

While most public companies, including larger financial institutions, have moved away from the use of the shortcut method, it is used extensively in the private sector. Private sector lending practices have evolved over the past several years to the point where it is a common practice for banks to issue only variable-rate long-term debt. Often in connection with this debt, the debtors are required to enter into an interest rate swap agreement to convert to an effective fixed-rate loan. Both the lenders and the borrowers have become more adept at





crafting the terms of these agreements to qualify for the shortcut method. The recent clarifications in DIG Issue E23, Issues Involving the Application of the Shortcut Method under Paragraph 68, provided additional useful guidance. Elimination of the shortcut method would create an operational burden for these private companies and they would now need to implement systems, procedures and policies, to address the potential ineffectiveness on an annual basis.

An alternative approach that may be considered is to permit the following scenario:

If the interest rate swap entered into at the issuance of an entity's own debt is determined to be highly effective in managing the interest cash flows associated with the hedged debt, then absent any occurrences that would change that initial relationship, such as partial prepayments, etc., the entity could continue to assume no ineffectiveness on an annual basis.

This approach would, in effect, retain the benefits of the shortcut method for private entities, while eliminating the rigid rules-based methodology of the shortcut method. TIC believes that this approach is more aligned with a principles based standard.

If the FASB eliminates the shortcut method, TIC recommends that the final standard include an example of the accounting for a typical interest rate swap to illustrate the new accounting and to assist preparers and practitioners with the learning curve that will be necessary as a result of the accounting change.

TIC is also concerned with the effects of the shortcut method elimination on smaller financial institutions, which are or will be implementing several other significant accounting changes (new disclosures under SFAS No. 140 [Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities] for public banks and SFAS 157, Fair Value Measurements) at the same time as this proposed standard. They do not have the internal resources of larger banks to cope with a myriad of changes at one time.

Finally, TIC believes the documentation requirement for nonpublic entities that hedge the interest payments in their own debt could be simplified in many cases. For example, where interest rate swaps have been structured to represent perfect hedges of variable rate debt, TIC believes the hedging instrument would, in and of itself, represent "substantive contemporaneous documentation" of the hedging instrument's effectiveness. TIC therefore recommends that the Board consider this additional simplification step to improve the efficiency and consistency of documentation for nonpublic entities.





Issue 4: This proposed Statement would modify the effectiveness threshold necessary for applying hedge accounting from *highly effective* to *reasonably effective* at offsetting changes in fair value or variability in cash flows.

Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

TIC supports changing the criteria for hedge accounting from highly effective to reasonably effective.

Issue 5: This proposed Statement always would require an effectiveness evaluation at inception of the hedging relationship. After inception of the hedging relationship, an effectiveness evaluation would be required if circumstances suggest that the hedging relationship may no longer be reasonably effective.

Do you foresee any significant operational concerns in creating processes that will determine when circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness each reporting period?

Do you believe that requiring an effectiveness evaluation after inception only if circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? If so, why?

TIC agrees with the concept of requiring another effectiveness assessment only in situations which indicate a change in circumstances may render the hedge ineffective. However ,the standard should employ a triggering event concept and provide some examples of situations which may indicate a change in circumstances. If guidance is provided in the final standard on triggering event, TIC does not foresee any significant operational issues with the concept.

Issue 6: The Board considered but decided against eliminating any assessment of effectiveness after the inception of the hedging relationship. The Board believes that eliminating such an assessment of effectiveness could result in the continuation of hedge accounting even when situations suggest that the hedge relationship may no longer be reasonably effective. Some observe that an implication of the decision to not eliminate any assessment after the inception of the hedging relationship could be that hedge accounting results would be reflected in some reporting periods and not in other reporting periods





throughout the life of the relationship. Also, in a hedge accounting model that generally does not permit hedging of individual risks, changes in the relationship between the individual risks being managed and those not being managed could increase the likelihood that the hedging relationship would no longer be reasonably effective. That would result in hedge accounting no longer being permitted for a portion of an expected hedge term. That "in and out" of hedge accounting would make it more difficult for users to interpret financial statements.

Do you agree with the Board's decision to continue to require that hedge accounting be discontinued if a hedge becomes ineffective? Alternatively, should an effectiveness evaluation not be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term?

TIC supports the alternative presented above which states that "an effectiveness evaluation [would] not be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term."

It seems that if the hedge itself would no longer be effective, the ineffective component of the changes in fair value would be reflected in operating income. This accounting would create the same effect as terminating the hedge. TIC does not believe that the amount, if any, that would remain in accumulated other comprehensive income for a period of time, would present a significant distortion, particularly with nonpublic entities.

Presentation of Hedging Gains and Losses

Issue 7: In the statement of operations, Statement 133 does not prescribe the presentation of gains and losses associated with hedging instruments, including the effective portion, the ineffective portion, and any amounts excluded from the evaluation of effectiveness, such as forward points. Some have suggested that such a prescription would improve financial reporting by creating consistency in the presentation of these amounts across all entities. Others observe that FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities, requires disclosure about that information, and they question whether a prescriptive approach is appropriate given the diverse hedge accounting strategies employed by entities.

Do you believe that Statement 133 should be amended to prescribe the presentation of these amounts? For example, the Statement could require that the effective portion of derivatives





hedging the interest rate risk in issued debt be classified within interest expense and that the ineffective portion and any amounts excluded from the evaluation of effectiveness be presented within other income or loss.

TIC does not believe that the Board should specify the presentation requirements. SFAS No. 161 provides sufficient transparency. In paragraph A59 of the ED, the dissenting members of the Board stated that SFAS 161 would provide suitable disclosures until a joint IASB/FASB project on derivatives and hedge account could be completed.

Effective Date and Transition

Issue 8: The Board's goal is to issue a final Statement by December 31, 2008. The proposed Statement would require application of the amended hedging requirements for financial statements issued for fiscal years beginning after June 15, 2009, and interim periods within those fiscal years.

Do you believe that the proposed effective date would provide enough time for entities to adopt the proposed Statement? Why or why not?

TIC prefers that this ED be deferred in the interest of international convergence (see Issue 11 below). However, if the Board proceeds to a final standard and issues the final standard by December 31, 2008, the proposed effective date will provide enough time for implementing the changes. However, if the standard is delayed into the first or second quarter of 2009, TIC believes the effective date should be changed to fiscal years beginning after December 15, 2009.

Issue 9: The Board did not prescribe any specific transition disclosures upon the adoption of this Statement.

Do you believe that there are specific disclosures that should be required during transition? If so, what? Please be specific as to how any suggested disclosures would be used.

TIC believes the standard disclosures required by Paragraph 17 of SFAS 154, Accounting Changes and Error Corrections, should be sufficient for this change.

Issue 10: The Board decided to permit an entity a one-time fair value option election under FASB Statements No. 156, Accounting for Servicing of Financial Assets, and No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, for (a) servicing assets and servicing liabilities designated as a hedged item on the date immediately preceding initial





application and (b) eligible financial instruments designated as a hedged item on the date immediately preceding initial application of this proposed Statement.

Do you agree with the Board's decision to allow a one-time fair value option at the initial adoption of this proposed Statement? Do you agree with the Board's decision to limit the option to assets and liabilities that are currently designated as hedged items under Statement 133?

Yes, TIC supports the Board's decision to permit fair value option elections under FAS 156 and FAS 159 for previously hedged items. TIC would also recommend that the board permit the fair value option under FAS 156 or FAS 159 to be elected for other items that had not been previously hedged, in order to enable entities to implement other hedging strategies using existing assets and liabilities.

Benefit-Cost Considerations

Issue 11: The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The benefit-cost considerations considered by the Board are provided in paragraphs A43–A50 in Appendix B of this proposed Statement.

Do you believe the Board identified the appropriate benefits and costs related to this proposed Statement? If not, what additional benefits or costs should the Board consider?

While TIC does not disagree with the Board's analysis of Costs and Benefits, TIC believes the Board should carefully consider the potential for additional costs into the future if interim amendments to SFAS No. 133 are adopted prior to the completion of the joint IASB/FASB derivatives and hedging project. Additional IASB/FASB differences in the accounting for hedging activities should not be introduced at this time. This adds to complexity and creates unnecessary confusion for preparers and practitioners. TIC recommends that current practice continue until both boards can reach convergence on a new comprehensive standard.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,





Stephen Bodine

Stephen Bodine, Chair PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committee

