November 21, 2016

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

By e-mail: director@fasb.org

Re: Proposed Accounting Standards Update—*Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

(File Reference No. 2016-310)

Dear Ms. Cosper:

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 26,000 CPAs in public practice, business, government and education, welcomes the opportunity to comment on the above-captioned exposure draft.

The NYSSCPA's Financial Accounting Standards Committee deliberated the proposed accounting standards update and prepared the attached comments. If you would like additional discussion with us, please contact Craig T. Goodman, Chair of the Financial Accounting Standards Committee, at (212) 324-7048, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

F. Michael Zovistoski
President

Attachment

NEW YORK STATE SOCIETY OF

CERTIFIED PUBLIC ACCOUNTANTS

COMMENTS ON

PROPOSED ACCOUNTING STANDARDS UPDATE—*DERIVATIVES AND HEDGING (TOPIC 815): TARGETED IMPROVEMENTS TO ACCOUNTING FOR HEDGING ACTIVITIES*

(File Reference No. 2016-310)

November 21, 2016

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Roseanne T. Farley
Jo Ann Golden
Craig T. Goodman
John J. McEnerney
Margaret A. Wood

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NYSSCPA Staff

Ernest J. Markezin
Keith Lazarus

New York State Society of Certified Public Accountants

Comments on

Proposed Accounting Standards Update—*Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*

(File Reference No. 2016-310)

General Comments

We welcome the opportunity to respond to the Financial Accounting Standards Board's (FASB or the Board) Proposed Accounting Standards Update—*Derivatives and Hedging (Topic 815) – Targeted Improvements to Accounting for Hedging Activities* (Proposed Update).

We are pleased that the Board's proposal will not rely substantially on entities' risk management objectives. This approach was suggested in the Board's most recent issuance on potential hedge accounting, a 2011 Discussion Paper on the International Accounting Standards Board's (IASB's) hedge accounting proposal. We noted our objections to such an approach in our April 27, 2011 comment letter. We also appreciate that the "highly effective" threshold for hedge effectiveness has been retained rather than being replaced by a less robust "reasonably effective" threshold as discussed in previous proposals. While we agree with the Board's goals of simplifying hedge accounting and better aligning accounting with the economics of hedging, we remain concerned with revisions that may allow entities to misrepresent their financial results.

The Proposed Update does not change that hedge accounting is optional within GAAP. Consequently, we suggest that the Board consider whether other alternatives should be created for entities that decide not to follow hedge accounting, perhaps due to complexity and or costs. Entities that engage in derivatives transactions for "economic hedging" purposes but do not follow hedge accounting may increase volatility in their financial statements by only fair valuing the derivatives. Two possible alternatives are: (1) expand the fair value option to fair value both sides of corresponding transactions; and (2) permit "synthetic accounting" for those transactions where the exchange is limited to converting a fixed-rate financial instrument to an instrument with variable rates, and vice versa.

Specific Comments

We have the following responses to questions posed in the Proposed Update.

Question 1: The Board decided it would allow an entity to designate the hedged risk as the variability in cash flows attributable to changes in a contractually specified component stated in the contract in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset. Do you agree with that decision? Please explain why or why not. If not, what specific alternatives should the Board consider? Please explain why those alternatives would be beneficial.

Response: We agree with the Board's decision since it reasonably addresses an area used in risk management for which hedge accounting is not currently available.

Question 2: The Board decided that it would retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments and forecasted issuances or purchases of fixed-rate financial instruments, maintain the existing list of permissible benchmark rates, and add the SIFMA Municipal Swap Rate to the list.

a. **Should the Board retain the current concept of benchmark interest rates for fair value hedges of fixed-rate financial instruments and for cash flow hedges of forecasted issuances or purchases of fixed-rate financial instruments? Please explain why or why not.**

Response: The Board should retain benchmark interest rates to provide greater certainty and comparability. We also agree with adding the SIFMA Municipal Swap Rate to the list.

b. **If the Board continues to maintain the current concept of benchmark interest rates, should the Board consider within the concept expectations that a rate will become widely used?**

Response: Each interest rate should already be widely used before being included among accepted benchmark interest rates.

c. **If the Board continues to maintain a list of rates, are there any other rates that should be added to the list? Please explain why a particular rate meets the definition of a benchmark rate.**

Response: We have no other potential benchmark interest rates to suggest. We recommend that the Board require the new standard to be reviewed on a regular basis by the Emerging Issues Task Force to determine whether benchmark interest rates should be added or deleted. Alternatively, the Board should consider developing a new methodology for periodically evaluating and adding or deleting benchmark interest rates.

d. **Are there other alternatives to the current concept of benchmark interest rates the Board should consider (for example, a principles-based approach)? Please describe those alternatives.**

Response: We prefer that the concept of benchmark interest rates be retained, with the possibility of adding or deleting benchmark interest rates in the future as described in our response to Question 2c.

Question 3: The Board decided that it would allow an entity to use either the full contractual coupon cash flows or the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in the fair value of the hedged item attributable to interest rate risk, except when the current market yield of the financial instrument is below the benchmark rate at hedge inception. In that instance, the total contractual coupon cash flows would have to be used. Do you agree with this decision? Please explain why or why not.

Response: We agree with this decision since it provides a pragmatic solution to bridge current and future GAAP. We recommend that the methodology used be consistently applied and clearly disclosed.

Question 4: In regard to hedging forecasted transactions, paragraph 815-30-40-5, as amended, states that "a pattern of determining that hedged forecasted transactions are probable of not occurring would call into question both an entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions." What is your policy on what constitutes a pattern? Are there certain instances or scenarios in which missed forecasts should not be incorporated into the consideration of this pattern?

Response: We recommend leaving the determination of what constitutes a pattern to the judgment of preparers and external auditors rather than attempting to create a safe harbor bright line. This would acknowledge significant differences between entities. The determination of a pattern should assess all factors involved, and we would not ignore any instances or scenarios in considering a pattern.

Question 6: Do you agree with the following Board decisions on presentation? Please explain why or why not. If not, what other alternatives should the Board consider?

a. **For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would modify current GAAP by requiring the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is presented.**

Response: We agree with the proposed change since it better reflects economic reality and should improve comparability.

b. **For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would retain current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded currently in earnings. For qualifying fair value and cash flow hedges, the proposed amendments would modify current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. For qualifying net investment hedges, there will be no prescribed presentation requirements for changes in the fair value of the hedging instrument excluded from the assessment of effectiveness.**

Response: We agree.

c. **For cash flow hedges in which the hedged forecasted transaction is probable of not occurring, the proposed amendments would retain current GAAP by requiring amounts recorded in accumulated other comprehensive income to be reclassified to**

earnings immediately. However, the proposed amendments would require presentation of reclassified amounts in the same income statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.

Response: We agree for the same reasons expressed in our response to Question 6a.

Question 7: Do you agree with the proposed disclosure amendments in (a), (b), and (c) below? Please explain why or why not.

a. **Cumulative basis adjustments related to fair value hedges.**

Response: We agree since this information should help financial statement users gain additional insights into the impact of hedge accounting on the balance sheet.

b. **Quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals.**

Response: We agree, but we recommend that the Board clarify the basic disclosures it expects to see to enhance comparability. This should provide users with a deeper understanding about the objectives and results of hedge accounting. This linkage should represent an important improvement in disclosures.

c. **Revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items.**

Response: We agree; this provides users with more descriptive information about the impact on the income statement.

Question 8: Unless the hedging relationship meets one of the exceptions that assumes perfect offset at hedge inception, an entity would be required to perform an initial quantitative test of hedge effectiveness and would be allowed to perform subsequent hedge effectiveness assessments qualitatively unless facts and circumstances change. Do you agree with this proposed change? Please explain why or why not.

Response: We disagree with the proposed change. An annual quantitative test should be performed to ensure that each hedge remains highly effective. To have this occur only when "facts and circumstances change" provides an incentive to not fully evaluate effectiveness and makes it possible that subsequent quantitative tests may not be performed. The indicators listed in proposed paragraph 815-20-35-2C may be interpreted to avoid quantitative testing. The Board should also consider that immaterial changes that alone would not impact a highly effective hedge may have a cumulative effect over several years which could make the hedge ineffective.

While we are knowledgeable about the current interest rate swap alternative for private companies, we recommend that the Board consider an exception to the requirement for quantitative testing at hedge inception and presume no hedge ineffectiveness for those transactions that meet all of the following criteria:

- The risk being hedged is variable interest rate risk on long term debt collateralized by real property (i.e., a mortgage).
- The hedging instrument is a simple pay fixed receive floating interest rate swap.
- The notional amount of the swap is the same as the outstanding principal amount of the loan at hedge inception.
- The outstanding principal amount of the loan does not change during the term of the hedge.
- The formula for computing net settlements remains the same throughout the swap (i.e., the fixed rate remains the same and the variable rate index does not change).
- The counterparties to the debt agreement and the counterparties to the swap agreement are the same.
- The transactions are entered into simultaneously.
- The fair value of the swap at inception is zero.

These types of transactions are structured essentially to create collateralized long term synthetic fixed rate debt. Alternative (2) in our General Comments could also address this issue. For such an exception, assessing hedge effectiveness going forward could be performed on a qualitative basis, with subsequent testing consistent with our response to Question 9.

Question 9: The Board decided that an entity may elect at hedge inception to perform subsequent assessments of effectiveness qualitatively. However, certain changes in the facts and circumstances associated with the hedging relationship in subsequent periods may require a quantitative assessment of effectiveness to be performed. Once an entity determines that a quantitative assessment of effectiveness is required, the entity would be prohibited to return to qualitative testing in periods after this determination is made. Can situations arise in which an entity no longer may assert qualitatively that the hedging relationship continues to be highly effective but when tested quantitatively would be highly effective? If so, please describe those circumstances. Should an entity be allowed to return to qualitative testing after such a significant change in facts and circumstances precluded it in a prior period? If so, please discuss the factors that an entity should consider to justify a reasonable expectation that the hedge will once again be highly effective on a qualitative basis.

Response: We reiterate our preference for the approach stated in our response to Question 8. However, if the Board does not require annual quantitative testing, we would suggest to permit an entity to return to qualitative testing if the required quantitative testing resulted from unusual, temporary circumstances such as a major market disruption.

Question 10: Do you agree with the proposed amendment that would allow an entity to perform the initial quantitative testing portion of hedge documentation at any time between hedge inception and the quarterly effectiveness testing date using data applicable as of the date of hedge inception? Please explain why or why not.

Response: We agree with this proposed amendment as a reasonable means of reducing financial statement preparers' burden.

Question 11: The proposed amendments related to the timing of the preparation of hedge documentation and subsequent qualitative testing apply to both public entities and private companies. Are there valid reasons why the content of or the timing of the preparation of hedge documentation should be different for public entities and private companies? If so, please describe the specific types of transactions for which different treatment should be considered.

Response: The content and timing of hedge documentation should be consistent for both public entities and private companies. Private companies willing to accept the complexities of hedge accounting should be able to comply with documentation requirements.

Question 12: Should the effective date be the same for both public business entities and entities other than public business entities?

Response: We favor having the same effective date for all entities, but allow sufficient time due to the system changes required. See our response to Question 13.

Question 13: How much time is needed to implement the proposed amendments? Should entities other than public business entities be provided more time? If so, how much more time?

Response: At a minimum, the effective date should not occur until one full year following the next calendar year-end after issuance, and become effective at the beginning of a fiscal year.

Question 14: Do you agree with the proposed transition method and disclosures in paragraph 815-20-65-3? Do you agree with the Board's decision not to allow a retrospective transition approach? Please explain why or why not.

Response: We agree as this provides the most sensible approach.

Additional Comments

As an additional comment, page 354 in the Proposed Update includes mention that the IASB currently has a separate project on macro or portfolio hedge accounting. We caution the Board against pursuing a project along these lines as it inherently has significant potential to increase the manipulation of financial results.