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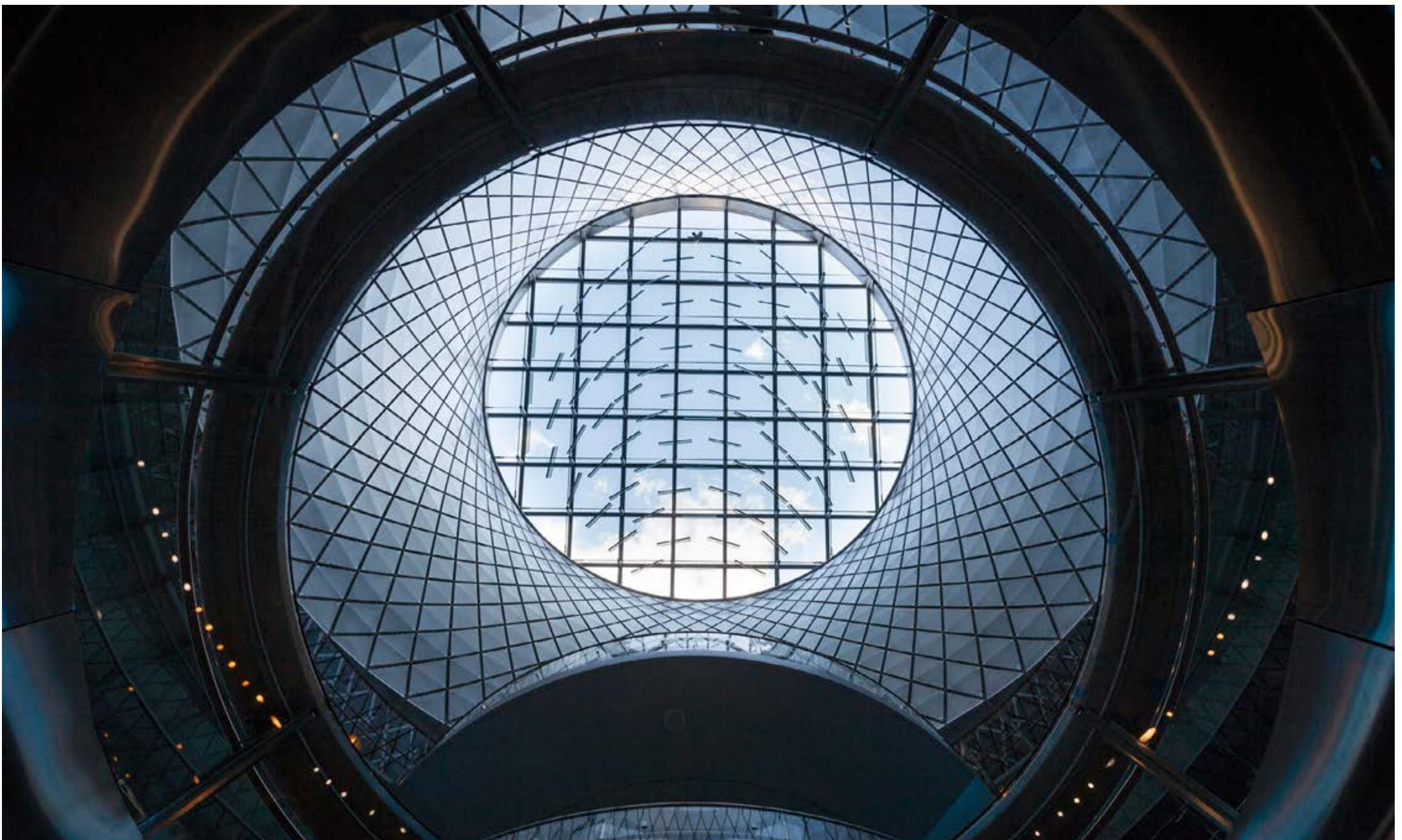

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FASB Proposes Targeted Improvements to Hedge Accounting
Relief Is Coming

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Introduction

On September 8, 2016, the FASB issued a proposed ASU[1] that would amend the hedge accounting recognition and presentation requirements of ASC 815[2] to (1) reduce their complexity and simplify their application by preparers and (2) improve the transparency and understandability of information conveyed to financial statement users about an entity's risk management activities by better aligning those activities with the entity's financial reporting for hedging relationships.

Although the changes proposed by the FASB are significant, constituents also should take note of those aspects of existing hedge accounting that the Board decided to retain. The proposal still would require all hedging relationships to be highly effective. Moreover, an entity

[1] FASB Proposed Accounting Standards Update, *Targeted Improvements to Accounting for Hedging Activities*.
[2] FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*.

would retain the ability to voluntarily dedesignate a hedging relationship, designate certain component risks of the hedged item as the hedged risk, and apply the critical-terms-match method or the shortcut method.

The FASB will determine the effective date of the proposed amendments after it considers constituent feedback; however, it has tentatively determined that earlier application of the proposed amendments will be permitted at the beginning of any fiscal year before the effective date.

Comments on the proposed ASU are due by November 22, 2016. The Board also will sponsor public roundtable meetings (tentatively scheduled for December 2, 2016) to discuss the proposed amendments. Participants in the roundtable sessions will need to submit their comments by November 4, 2016.

This *Heads Up* summarizes the proposed ASU's key provisions. The appendixes of this *Heads Up* contain (1) the proposal's questions for respondents, which have been reproduced for ease of reference, and (2) a high-level comparison of the proposed hedging model to existing U.S. GAAP and the IASB's standard on hedging, IFRS 9.[3]

Key Proposed Changes to the Hedge Accounting Model

Elimination of the Concept of Separately Recognizing Periodic Hedge Ineffectiveness

The proposed amendments would eliminate the concept of separately recognizing periodic hedge ineffectiveness (although under the mechanics of fair value hedging, economic ineffectiveness would still be reflected in current earnings for those hedges). The Board's rationale for this decision is that the entire change in the fair value of the hedging instrument represents a cost of hedging; accordingly, presenting that whole change in the same income statement line as the earnings effect of the hedged item provides "a more faithful representation of an entity's risk management activities." Under this rationale, even a portion of the change in a hedging instrument's fair value that is excluded from a hedging relationship's effectiveness assessment is considered a cost of hedging that should be recognized in the same income statement line as the earnings effect of the hedged item (other than amounts excluded from the assessment of effectiveness of net investment hedges). Furthermore, this rationale extends to "missed forecasts" as well. Thus, an entity that ultimately determines that it is probable that a hedged forecasted transaction will not occur would record the amounts reclassified out of accumulated other comprehensive income (AOCI) for that hedging relationship into earnings in the same income statement line that would have been affected by the forecasted transaction.

Editor's Note

The Board acknowledges that, unlike the existing hedge accounting model, its proposed model will defer the timing of recognition of any economic ineffectiveness arising from cash flow or net investment overhedges (and eliminate recognition of ineffectiveness arising from net investment underhedges); however, it believes that the new model will benefit constituents by (1) reducing the costs of administering a hedging program and (2) allowing users to more clearly identify how an entity's hedging program has affected its financial statements, thereby resulting in more decision-useful information.

[3] IFRS 9, *Financial Instruments*, also allows entities to elect to continue to follow the hedge accounting provisions of IAS 39, *Financial Instruments: Recognition and Measurement*.

Recognition and Presentation of Changes in the Fair Value of Hedging Instruments

The following table summarizes key aspects of the amended hedge accounting and presentation model described in the proposal:

Fair Value Hedges	Cash Flow Hedges	Net Investment Hedges
• The entire change in the fair value of the hedging instrument would be recorded in the same income statement line as the earnings effect of the hedged item.[4] • The entire change in fair value of the hedged item attributable to the hedged risk would be recorded in income/loss and as an adjustment to the carrying amount of the hedged item.	• The entire change in the fair value of the hedging instrument used to assess hedge effectiveness would be recorded in other comprehensive income (OCI). • When the hedged item affects earnings, amounts would be reclassified out of AOCI and presented in the same income statement line in which the earnings effect of the hedged item is presented.[5] • The portion (if any) of the hedging instrument's change in fair value that is excluded from the hedge effectiveness assessment would be recognized immediately in the same income statement line in which the earnings effect of the hedged item is presented.	• The entire change in the fair value of the hedging instrument used to assess hedge effectiveness would be recorded in the cumulative translation adjustment (CTA) in OCI. • When the hedged net investment affects earnings (i.e., upon a sale or liquidation), amounts would be reclassified out of CTA and be presented in the same income statement line in which the earnings effect of the net investment is presented.[6] • The portion (if any) of the hedging instrument's change in fair value that is excluded from the hedge effectiveness assessment would be recognized immediately in income (although the income statement presentation would not be prescribed).

Hedge Effectiveness Assessments and Documentation Requirements

Quantitative Versus Qualitative Assessments of Hedge Effectiveness

The proposal would require an entity to perform an initial prospective quantitative hedge effectiveness assessment (by using either a dollar-offset test or a statistical method such as regression) unless the hedging relationship qualifies for application of one of the expedients that permits an assumption of perfect hedge effectiveness (e.g., the shortcut or critical-terms-match methods).

An entity would be permitted to perform the initial prospective quantitative hedge effectiveness assessment after hedge designation by using information available at hedge inception; however, the entity would have to complete that assessment by the earlier of:

- "The first quarterly hedge effectiveness assessment date."
- "The date that financial statements that include the hedged transaction are available to be issued."
- "The date that [any required hedging criterion] no longer is met."
- "The date of expiration, sale, termination, or exercise of the hedging instrument."

[4] When a hedging relationship involves multiple hedged items or risks that affect more than one income statement line, the entity would be required to allocate the total change in the hedging instrument's fair value to the appropriate income statement lines.
[5] See footnote 4.
[6] See footnote 4.

- "The date of dedesignation of the hedging relationship."
- "For a cash flow hedge of a forecasted transaction . . . the date that the forecasted transaction occurs."

If (1) an entity's initial prospective quantitative hedge effectiveness assessment of a hedging relationship demonstrates there is a highly effective offset, and (2) the entity can, at hedge inception, "reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods," the entity may elect to perform subsequent retrospective and prospective effectiveness assessments qualitatively. To do so, in the hedge documentation it prepares at hedge inception, it must (1) specify how it will perform the qualitative assessments and (2) document the alternative quantitative assessment method that it would use if it later concludes, on the basis of a change in the hedging relationship's facts and circumstances, that subsequent quantitative assessments will be necessary.

Editor's Note

The proposal notes that an entity's determination of whether it can reasonably support an expectation of high effectiveness will require the use of judgment and that the entity should consider (1) the results of the initial prospective quantitative hedge effectiveness assessment, (2) the extent to which the critical terms of the hedging instrument and the hedged item are aligned, and (3) the degree and consistency of correlation between changes in the underlyings of the hedging instrument and the hedged item.

The proposal also states that "[a]n entity must document that it will perform the same quantitative assessment method for both initial and subsequent prospective hedge effectiveness assessments." Moreover, the proposal indicates that an entity that elects to perform subsequent qualitative effectiveness assessments should do so for all similar hedging relationships.

The proposal states that after an entity makes its initial election, "whenever financial statements or earnings are reported and at least every three months, [it must] verify and document that the facts and circumstances related to the hedging relationship have not changed to an extent that it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective." Indicators that may (individually or in the aggregate) allow an entity to continue to assert qualitatively that a hedging relationship continues to be highly effective include:

- "The factors that were assessed at the inception of the hedging relationship that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis have not changed to an extent that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective."
- "There have been no adverse developments regarding the risk of counterparty default."
- "In a cash flow hedge of a variable-rate financial instrument with an interest rate cap or interest rate floor in which effectiveness is assessed in accordance with paragraph 815-20-25-100, the variable rate does not approach or move above or below the rate associated with the cap or floor."
- "In a cash flow hedge of the variability in cash flows attributable to changes in a contractually specified component in a forecasted purchase or sale of a nonfinancial asset with a cap or floor in which effectiveness is assessed in accordance with

paragraph 815-20-25-100, the price associated with the contractually specified component does not approach or move above or below the price associated with the cap or floor."

Editor's Note

An entity that initially elects to perform subsequent qualitative effectiveness assessments but later determines that the hedging relationship's facts and circumstances have changed to the extent that qualitative assessments are no longer sufficient, would be required to quantitatively assess effectiveness at the time of the change and for the duration of the hedging relationship. The entity would not be able to revert to making qualitative effectiveness assessments at any time after such a change.

Amendments to Benchmark Interest Rates and the Definition of Interest Rate Risk

The proposed amendments would redefine the term "interest rate risk" as follows to describe hedgeable risks:

- "For recognized variable-rate financial instruments and forecasted issuances or purchases of variable rate financial instruments, interest rate risk is the risk of changes in the hedged item's cash flows attributable to changes in the contractually specified interest rate in the agreement."
- "For recognized fixed-rate financial instruments, interest rate risk is the risk of changes in the hedged item's fair value attributable to changes in the designated benchmark interest rate. For forecasted issuances or purchases of fixed-rate financial instruments, interest rate risk is the risk of changes in the hedged item's cash flows attributable to changes in the designated benchmark interest rate."

Thus, the benchmark interest rate concept would be eliminated for variable-rate financial instruments under the proposed amendments but retained for fixed-rate financial instruments.

As indicated in the definition of interest rate risk, in cash flow hedges of interest rate risk associated with forecasted issuances or purchases of debt, the nature of the hedgeable risk will depend on the characteristics of the forecasted transaction. An entity that knows it will issue or purchase fixed-rate debt would hedge the variability in cash flows associated with changes in the benchmark interest rate; for a forecasted issuance or purchase of variable-rate debt, the entity would hedge the variability in cash flows associated with changes in the contractually specified rate. If the entity is unsure about the nature of its forecasted transaction, it would designate as the hedged risk the variability in cash flows attributable to a change in a rate that would qualify both as a benchmark interest rate (if the forecasted transaction ultimately was fixed rate) and as a contractually specified rate (if the forecasted transaction ultimately was variable rate).

Under the proposal, the Securities Industry and Financial Markets Association Municipal Swap Index (SIFMA) swap rate would also be added to those benchmark interest rates already permitted in the United States under U.S. GAAP[7] to make it easier for entities to hedge interest rate risk for fixed-rate tax-exempt financial instruments.

[7] The other benchmark interest rates for the United States specified in ASC 815-20-25-6A are (1) interest rates on direct Treasury obligations of the U.S. government, (2) the London Interbank Offered Rate (LIBOR) swap rate, and (3) the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate).

Shortcut Method and Critical-Terms-Match Method

The proposal retains both the shortcut and critical-terms-match methods and provides additional relief for entities applying those methods. As a response to concerns about the number of restatements that have resulted from attempted application of the shortcut method, the proposal would amend the shortcut accounting requirements to allow an entity to specify, at the inception of the hedging relationship, the quantitative (long-haul) method it will use to assess hedge effectiveness and measure hedge results if it later determines that application of the shortcut method was not or no longer is appropriate. Before being able to use this alternative quantitative method (and avoid having to dedesignate the original hedging relationship), the entity would have to have demonstrated that:

> a. [It] documented at hedge inception . . . which quantitative method it would use to assess hedge effectiveness and measure hedge results if the shortcut method was not or no longer is appropriate during the life of the hedging relationship[; and]
>
> b. The hedging relationship was highly effective on a prospective and retrospective basis in achieving offsetting changes in fair value or cash flows attributable to the hedged risk for the periods in which the shortcut method criteria were not met.[8]

If criterion (a) is not satisfied, the hedging relationship would be invalid in the period in which the shortcut method criteria were not satisfied and all subsequent periods; otherwise (if criterion (a) is met), the hedging relationship would be invalid in all periods in which criterion (b) was not satisfied.

Editor's Note

Even if an entity can continue the hedging relationship by using a quantitative effectiveness assessment and measurement method because both criteria are met, the entity still must apply the ASC 250[9] error correction guidance "to the difference, if any, between the results recorded from applying the shortcut method and the quantitative method documented [at hedge inception]." Doing so ensures that any material differences would still be treated as errors in the financial statements, although presumably the size of the error would not be significant if the hedging relationship was highly effective. If either criterion is not met, an entity must apply the error correction guidance to the difference between the results recognized through application of the shortcut method and the results of not applying hedge accounting. These types of errors are more likely to be material, although that ultimate determination will depend on the specific characteristics of the hedging relationship.

In addition, the proposal amends certain shortcut-method criteria to allow partial-term fair value hedges to qualify for the shortcut method.

The proposal also expedites an entity's ability to apply the critical-terms-match method to cash flow hedges of groups of forecasted transactions. If all other critical-terms-match criteria are satisfied, such hedges will qualify for the critical-terms-match method if all the forecasted transactions occur within 31 days of the hedging derivative's maturity.

Fair Value Hedges of Interest Rate Risk

Measurement of Changes in the Hedged Item's Fair Value

Under the proposal, for a fair value hedge of interest rate risk, an entity may choose to use either (1) total contractual coupon cash flows or (2) the benchmark rate component of those

[8] To make this effectiveness assessment, an entity should use the terms of the hedging instrument and hedged item that existed at the date the hedging relationship no longer met the shortcut method criteria. In cash flow hedges that use a hypothetical derivative as a proxy for the hedged item, the hypothetical derivative would be set to a value of zero as of hedge inception.

[9] FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.

contractual coupon cash flows to calculate the change in the hedged item's fair value that is attributable to changes in the benchmark interest rate. However, if the current market yield of the hedged item is less than the benchmark interest rate at hedge inception (i.e., a "sub-benchmark" hedge), the entity would be required to use the total contractual coupon cash flows for its calculation.

Measuring the Fair Value of a Prepayable Instrument

For prepayable instruments such as callable debt, an entity would continue to consider the changes in the embedded prepayment option's fair value when determining the change in the fair value of the hedged instrument in a fair value hedge of interest rate risk. However, under the proposal, "the factors incorporated for the purpose of adjusting the carrying amount of the hedged item shall be the same factors that the entity incorporated for the purpose of assessing hedge effectiveness."

Therefore, when, for example, an entity (1) assessed hedge effectiveness in a fair value hedge of interest rate risk of callable debt and (2) measured the change in the fair value of callable debt attributable to changes in the benchmark interest rate, it could consider only how changes in the benchmark interest rate (and not changes in credit risk or other factors) would affect the obligor's decision to call the debt.

Partial-Term Hedges of Interest Rate Risk

The proposal also provides relief to entities that wish to enter into fair value hedges of interest rate risk for only a portion of the term of a financial instrument, which is typically unachievable under current U.S. GAAP. Under the proposed guidance, such partial-term hedges would be permissible, and an entity would measure the change in the fair value of the hedged item attributable to changes in the benchmark interest rate "using an assumed term that begins with the first hedged cash flow and ends with the last hedged cash flow." Also, the hedged item's assumed maturity would be the date on which the last hedged cash flow is due and payable.

Ability to Designate Components of Nonfinancial Assets as Hedged Items

The proposed guidance permits an entity to hedge the "risk of variability in cash flows attributable to changes in a contractually specified component"[10] in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset if the hedge meets the following criteria:

- "The purchase or sale contract for the nonfinancial asset creates an exposure related to the variability in cash flows attributable to changes in the contractually specified component throughout the life of the hedging relationship."
- "The stated components of the price of the nonfinancial contract all relate to the cost of purchasing or selling the nonfinancial asset in the normal course of business in a particular market."
- "All of the stated components of the price of the nonfinancial contract reflect market conditions at contract inception."

[10] A proposed amendment to the ASC master glossary defines a contractually specified component as "An index or price explicitly referenced in an agreement to purchase or sell a nonfinancial asset other than an index or price calculated or measured solely by reference to an entity's own operations."

Furthermore, an entity would be permitted to designate a hedge of a contractually specified component for a period that extends beyond the contractual term or when a contract does not yet exist to sell or purchase the nonfinancial asset if the criteria specified above will be met in a future contract and all the other cash flow hedging requirements are met.

Also, the proposal notes that an entity's ability to make a hedge designation would not be precluded if the variability in a hedged item's cash flows that is attributable to changes in the contractually specified component is limited by a cap or floor in the contract; however, the entity would need to consider such features in its assessment of hedge effectiveness.

Editor's Note

The Board believes that enabling entities to component hedge better reflects risk management activities in those entities' financial reporting. This decision also creates greater symmetry in the hedging models for financial and nonfinancial items because it will allow component hedging for both types of items.

Disclosure Requirements

The proposed ASU would add new disclosure requirements and amend existing ones. Also, to align the disclosure requirements with the proposed changes to the hedge accounting model, the proposal would remove the requirement for entities to disclose amounts of hedge ineffectiveness. In addition, entities would be required to provide:

- Tabular disclosure of (1) the total amounts reported in the statement of financial performance for each income and expense line item that is affected by hedging and (2) the effects of hedging on those line items.
- Disclosures about the carrying amounts and cumulative basis adjustments of items designated and qualifying as hedged items in fair value hedges.
- Qualitative disclosures describing (1) quantitative hedging goals, if any, established by an entity when developing its hedging objectives and strategies and (2) whether those goals were met.

These disclosures would be required for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented.

Transition and Adoption

Transition Method

Entities would adopt the proposal's provisions by applying a modified retrospective approach to existing hedging relationships[11] as of the adoption date. Under this approach, entities with cash flow or net investment hedges would record the cumulative effect of applying the new guidance related to recognition of hedging instruments in AOCI, with an offsetting adjustment to the opening balance of retained earnings as of the most recent period presented on the date of adoption. Furthermore, "the adjusted [AOCI] balance associated with the hedging relationship shall reflect the cumulative change in fair value of the hedging instrument since inception of the hedging relationship less any amounts" that would have been recognized in earnings.

After adoption, in all interim and annual periods, entities would begin to apply the new accounting and presentation model and provide the new and amended disclosures.

[11] Refers to hedging relationships in which "the hedging instrument has not expired, been sold, terminated, or exercised" and that have not been dedesignated by the entity as of the date of adoption.

In each annual and interim reporting period in the fiscal year of adoption, entities would also be required to provide certain disclosures required by ASC 250 about (1) the nature and reason for the change in accounting principle and (2) the cumulative effect of the change on the components of equity or net assets as of the date of adoption.

Transition Considerations for Fair Value Hedges of Interest Rate Risk

For fair value hedges of interest rate risk existing at the date of adoption, if an entity elects to apply the revised measurement methods related to (1) using the benchmark rate component of contractual coupon cash flows to measure changes in the hedged item's fair value attributable to changes in the benchmark interest rate or (2) hedging prepayable instruments, it would be required to consider that application as a dedesignation and redesignation of those hedging relationships. The entity would incorporate the cumulative basis adjustment of the hedged item from each dedesignated hedging relationship into the new hedging relationship. The entity would then adjust that amount to the amount that would have been recorded as of the adoption date had the entity applied the revised method in all periods for which the dedesignated hedging relationship was outstanding. The entity would make an offsetting adjustment to the opening balance of retained earnings as of the adoption date.

An entity that changes a tax-exempt financial instrument's hedged risk to the SIFMA benchmark interest rate would also have to essentially dedesignate and redesignate the hedging relationship. The entity would amortize the cumulative basis adjustment of the hedged item from the dedesignated hedge to earnings over the remaining life of the hedged item "on a level yield basis."

One-Time Transition Elections

Under the proposal, an entity can make the following one-time elections upon adoption:

- *For existing hedging relationships* — To amend hedge documentation to specify that subsequent prospective and retrospective effectiveness assessments will be performed qualitatively, without dedesignating the hedging relationship.
- *For existing shortcut-method hedging relationships* — To amend hedge documentation to specify how the entity will quantitatively assess hedge effectiveness and measure hedge results if it determines at a later date that use of the shortcut method was not or no longer is appropriate.
- *For existing cash flow hedging relationships that qualify for designation of (1) the variability in cash flows attributable to changes in a contractually specified component of the price for the purchase or sale of a nonfinancial asset or (2) a contractually specified variable interest rate as the hedged risk* — To, in the redesignated hedge, "create the terms of the instrument used to estimate changes in value of the hedged risk (either under the hypothetical derivative method or another acceptable method . . .) in the assessment of effectiveness on the basis of market data as of the inception of the dedesignated hedging relationship." Ineffectiveness previously recognized in the dedesignated hedging relationship (in which the hedged risk was the variability in total cash flows) would be included as part of the transition adjustment.

The proposal allows an entity to adopt any election it chooses — it does not have to adopt all the elections as a single package. Either of the first two elections above must be made by the end of the first fiscal year after adoption. An entity would need to make the third election on or before the first quarterly hedge effectiveness assessment date after adoption.

Comparison With IFRSs

ASC 815's current hedging guidance is similar to the hedge accounting model in IAS 39. To align the guidance on hedge accounting with an entity's risk management activities, the IASB issued amendments to IFRS 9 in 2013 that introduced a new general hedge accounting model to IFRSs. However, the FASB is proposing to largely retain the existing U.S. GAAP hedge accounting framework and instead incorporate targeted improvements to address various practice issues. Accordingly, many aspects of the hedge accounting models under IFRS 9 and U.S. GAAP would differ significantly. See Deloitte's November 26, 2013, ***Heads Up*** for additional information about the IFRS 9 hedge accounting model. Also, refer to Appendix B.

Appendix A — Questions for Respondents

The proposed ASU's questions for respondents are reproduced below for ease of reference.

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.

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.

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?

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.

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.

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.

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?

Question 5: Are there hedging relationships that would be eligible to meet the requirements in the proposed amendments and IFRS 9, but the hedge results would be recognized and presented differently? If so, please describe the transaction and why it would be recognized and presented differently in accordance with IFRS 9.

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.

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.

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.

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
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
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.

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.

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.

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.

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.

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

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?

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.

Appendix B — Comparison of Hedge Accounting Models

The table below compares certain aspects of the proposed amendments to the proposed hedge accounting model with current U.S. GAAP (ASC 815) and IFRS 9.

Subject	Current U.S. GAAP	Proposed Guidance (Tentative Approach)	IFRS 9
Proposed Amendments Applicable to All Hedges			
"Highly effective" threshold to qualify for hedge accounting	The hedging instrument must be highly effective at achieving offsetting changes in fair value or cash flows.	No changes would be made to existing requirements under U.S. GAAP.	A "highly effective" threshold concept does not exist; instead, IFRS 9 requires that (1) there is an economic relationship between the hedging instrument and the hedged item, (2) credit risk does not dominate the value changes that result from the economic relationship, and (3) the hedging relationship's hedging ratio reflects the actual quantity of the hedging instrument and the hedged item.
Quantitative assessment of hedge effectiveness	Entities must perform initial and ongoing quantitative prospective and retrospective assessments of effectiveness (unless the shortcut method is applied).	Generally requires an initial prospective quantitative test; however, entities can elect to subsequently perform only qualitative effectiveness assessments unless facts and circumstances change.	Does not specify a method for assessing effectiveness. Requires entities to make ongoing qualitative or quantitative assessments (at a minimum at each reporting date).
Hedge documentation and initial prospective quantitative hedge effectiveness assessment	Entities must complete all documentation at hedge inception.	Entities still must complete most hedge documentation at hedge inception; however, they need not complete the initial prospective quantitative hedge effectiveness assessment until the first quarterly hedge effectiveness assessment date (i.e., up to three months). Some circumstances may require earlier completion of the initial prospective quantitative effectiveness assessment.	Requires all documentation at hedge inception.
Income statement presentation	Income statement presentation of hedging results is not prescribed.	Requires presentation of the change in the hedging instrument's fair value in the same income statement line as the earnings effect of the hedged item (other than any fair value changes that are excluded from the hedge effectiveness assessment of net investment hedges, for which no specific income statement presentation is prescribed).	Does not prescribe income statement presentation of hedging results. Time value components that are not designated as part of the hedging instrument will generally be initially deferred in OCI and not recognized in current earnings.

(Table continued)

Subject	Current U.S. GAAP	Proposed Guidance (Tentative Approach)	IFRS 9
Proposed Amendments Applicable to All Hedges			
Voluntary dedesignation of a hedging relationship	Entities may voluntarily discontinue hedge accounting at any time by removing the designation of the hedging relationship.	No changes would be made to existing requirements under U.S. GAAP.	Entities may perform dedesignation only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria.
Shortcut method	Permitted for hedging relationships involving an interest rate swap and an interest-bearing financial instrument that meet specific requirements.	Existing model retained; however, application of the long-haul method would be permitted if an entity determines that use of the shortcut method was not or is no longer appropriate as long as: • The entity documented at hedge inception the quantitative method it would use to assess hedge effectiveness and measure hedge results if the shortcut method could not be applied. • The hedge was highly effective for the periods in which the shortcut method criteria were not met. The qualifying criteria also would be amended to enable partial-term fair value hedges to qualify for shortcut accounting.	Not permitted.
Proposed Amendments Applicable to Cash Flow Hedges			
Measurement and recognition of hedge ineffectiveness — cash flow hedges	Entities must perform periodic measurement and recognition of hedge ineffectiveness (other than that arising from cumulative cash flow underhedges).	Eliminates the requirement for entities to recognize hedge ineffectiveness each reporting period.	Requires entities to perform measurement and recognition of hedge ineffectiveness (other than that arising from cumulative cash flow underhedges) in each reporting period.
Ability to designate a component of a forecasted purchase or sale of a nonfinancial asset as a hedged item	Entities are prohibited from designating changes in cash flows of a component of a nonfinancial item as the hedged risk, with the exception of the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rate.	Permits entities to hedge the "risk of variability in cash flows attributable to changes in a contractually specified component" in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, if the hedge meets certain criteria.	Entities may designate nonfinancial components as hedged items under the principle that a component may be designated as a hedged item if it is separately identifiable and reliably measurable. There is no requirement that the component be contractually specified.

(Table continued)

Subject	Current U.S. GAAP	Proposed Guidance (Tentative Approach)	IFRS 9
Proposed Amendments Applicable to Cash Flow Hedges			
Hedges of interest rate risk for variable-rate financial instruments	The only hedgeable component is the change in cash flows attributable to changes in the benchmark interest rate.	Entities may designate the contractually specified interest rate index as the hedged risk. The concept of benchmark interest rate hedging is eliminated.	Entities may designate components that are separately identifiable and reliably measurable.
Application of critical-terms-match method to a cash flow hedge of a group of forecasted transactions	Entities need to consider whether the amount of hedge ineffectiveness that arises from differences between the hedging derivative's maturity date and the dates of the forecasted transactions is more than de minimis; if so, entities cannot apply this method and may need to view this as an accounting error.	Entities may use the critical–terms-match method when cash flow hedging a group of forecasted transactions if (1) those forecasted transactions occur within the same 31-day period as the maturity of the hedging derivative and (2) all other method requirements are met.	No formal approach; however, entities may be able to qualitatively assess hedge effectiveness when the critical terms of the hedging instrument and those of the hedged item match.
Proposed Amendments Applicable to Fair Value Hedges of Interest Rate Risk			
Eligible benchmark interest rates	SIFMA is not an eligible benchmark interest rate. The only permissible U.S. benchmark interest rates are rates for U.S. Treasuries, LIBOR swap rates, and the Fed Funds Effective Swap Rate (Overnight Index Swap Rate).	SIFMA is added as an eligible benchmark interest rate in the United States in addition to those rates already permitted under current U.S. GAAP.	Entities may designate components that are separately identifiable and reliably measurable.
Partial-term fair value hedges of interest rate risk	Although not explicitly prohibited, such hedges would rarely satisfy all the hedging criteria (e.g., being highly effective).	Entities may designate a partial-term hedge by assuming that (1) the term of the hedged item begins with the first hedged cash flow and ends with the last hedged cash flow and (2) the maturity of the hedged item occurs on the date on which the last hedged cash flow is due and payable. This greatly increases the likelihood that the hedging relationship will meet the "highly effective" criterion.	Entities may perform partial-term hedging.

(Table continued)

Subject	Current U.S. GAAP	Proposed Guidance (Tentative Approach)	IFRS 9
Proposed Amendments Applicable to Fair Value Hedges of Interest Rate Risk			
Measuring the change in fair value of a prepayable instrument (e.g., callable debt)	In a hedge of benchmark interest rate risk on fixed-rate debt containing a call feature, entities must consider the effect of that embedded prepayment option on the change in value of the debt (unless the shortcut method is applied). This consideration includes all factors that might lead to debt prepayment (interest rates, credit spreads, and other factors), even if only interest rate risk is being hedged.	Would allow entities to consider only how changes in the benchmark interest rate (as opposed to how all variables, such as interest rate, credit, and liquidity factors) would affect the exercise of the call option when assessing hedge effectiveness and measuring the change in fair value of the debt attributable to changes in the benchmark interest rate.	Does not provide specific guidance; however, in order for a layer component containing a prepayment option to be eligible for fair value hedging, entities must include the changes in the fair value of the prepayment option as a result of changes in the hedged risk when measuring the change in the hedged item's fair value.
Measuring the change in fair value of the hedged item attributable to the change in the benchmark interest rate in a fair value hedge of interest rate risk	An entity must measure the change in the hedged item's fair value attributable to changes in the benchmark interest rate by considering all contractual coupon cash flows of the hedged item.	Permits an entity to use either the benchmark rate component of contractual coupon cash flows or the full contractual coupon cash flows when calculating the change in fair value of the hedged item. However, if the hedged item's effective interest rate is less than the benchmark interest rate on the date of hedge designation (a "sub-benchmark" hedge), the entity must use the full contractual coupon cash flows.	Entities may designate the benchmark interest rate cash flows as the hedged item if they are separately identifiable and reliably measurable.

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