NAREIT Alert (October 14, 2016)

NAREIT Alert Important Industry Updates from NAREIT

October 14, 2016

FASB Issues Hedging Accounting Proposal

On Sept. 8, the Financial Accounting Standards Board (FASB or Board) issued a proposal (the Proposal) that would make targeted improvements to hedge accounting. The FASB's purpose in issuing the Proposal is to improve the financial reporting of hedging relationships in order to better portray the economic results of an entity's risk management activities in its financial statements. Additionally, the Proposal would simplify the application of the hedge accounting guidance in current U.S. Generally Accepted Accounting Principles (GAAP). Equity REITs and mortgage REITs that seek to qualify for hedge accounting in utilizing interest rate swaps or foreign currency swaps associated with debt instruments would be impacted by the Proposal. If you are interested in participating in a task force that will evaluate the Proposal and consider whether NAREIT should develop a submission, please contact Christopher Drula at cdrula@nareit.com by Oct. 20. Comments are due to the Board by Nov. 22.

Elimination of the separate recognition of periodic hedge ineffectiveness

The Proposal would eliminate the requirement in current GAAP to separately recognize periodic hedge ineffectiveness. Thus, the Proposal would require companies to present the entire change in the fair value of the hedging instrument in the same income statement line as the earnings effect of the hedged item. Current GAAP provides special hedge accounting only for the portion of the hedge deemed to be "highly effective" and requires an entity to separately reflect the amount by which the hedging instrument does not offset the hedged item, which is referred to as the "ineffective" amount.

Highly effective threshold to qualify for hedge accounting

In order to qualify for hedge accounting, companies would need to continue demonstrating that the hedging instrument is highly effective at achieving offsetting changes in fair value or cash flows.

Quantitative and qualitative assessment of hedge effectiveness

The Proposal would alleviate some of the ongoing requirements to demonstrate that hedges are highly effective. Under current GAAP, companies are required to perform initial and ongoing quantitative and retrospective assessments to qualify for hedge accounting. The Proposal would continue to require that companies perform an initial prospective quantitative test. However, the Proposal would allow companies to elect to subsequently perform only a qualitative (as opposed to a quantitative) assessment unless facts and circumstances change. This would represent a significant change from current GAAP, and would reduce the cost and administrative burden that companies endure to achieve hedge accounting on an ongoing basis.

Hedge documentation

The Proposal would continue to require that companies complete most of the hedge documentation at inception of the hedge. However, the Proposal would permit that the initial assessment be completed in conjunction with the quarter following the inception of the hedge relationship. Under current GAAP, the initial assessment must be completed at inception of the hedge.

Disclosure Requirements

The Proposal would modify disclosures required in current GAAP. The proposed modifications would include a tabular disclosure related to the effect on the income statement of fair value and cash flow hedges and would eliminate the requirement to disclose the ineffective portion of the change in fair value of hedging instruments. The proposed amendments also would require the following new disclosures:

- Disclosures related to cumulative basis adjustments for fair value hedges; and,
- Enhanced qualitative disclosures describing quantitative hedging goals, if any, set to achieve hedge accounting objectives.

Effective Date

The Board has not yet established an effective date for the Proposal. After the Board evaluates constituent input during the re-deliberations process, the Board will set the effective date.

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