

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2017-12
August 2017

Derivatives and Hedging (Topic 815)

Targeted Improvements to Accounting for Hedging Activities

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

Stakeholders indicated that the hedge accounting requirements in current generally accepted accounting principles (GAAP) sometimes do not permit an entity to properly recognize the economic results of its hedging strategies in its financial statements. Those stakeholders maintained that improvements to the hedge accounting model are needed to facilitate financial reporting that more closely reflects an entity's risk management activities. In addition, stakeholders note that the effect of hedge accounting on an entity's reported results often is difficult to understand and interpret. They emphasize that reported results should help financial statement users to better understand an entity's risk exposures and how hedging strategies are used to manage those exposures.

To address stakeholders' concerns, the Board has issued this Update with the objective of improving the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. In addition to that main objective, the amendments in this Update make certain targeted improvements to simplify the application of the hedge accounting guidance in current GAAP based on the feedback received from preparers, auditors, users, and other stakeholders.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to any entity that elects to apply hedge accounting in accordance with current GAAP.

What Are the Main Provisions and How Do They Differ from Current Generally Accepted Accounting Principles (GAAP)?

Alignment of Risk Management Activities and Financial Reporting

The amendments in this Update better align an entity's risk management activities and financial reporting for hedging relationships through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. To meet that objective, the amendments expand and refine hedge accounting for both nonfinancial and financial risk components

and align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements.

Risk Component Hedging

Current GAAP contains limitations on how an entity can designate the hedged risk in certain cash flow and fair value hedging relationships. To address those current limitations, the amendments in this Update permit hedge accounting for risk components in hedging relationships involving nonfinancial risk and interest rate risk as follows:

1. For a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, an entity could designate as the hedged risk the variability in cash flows attributable to changes in a contractually specified component stated in the contract. The amendments remove the requirement in current GAAP that only the overall variability in cash flows or variability related to foreign currency risk could be designated as the hedged risk in a cash flow hedge of a nonfinancial asset.
2. For a cash flow hedge of interest rate risk of a variable-rate financial instrument, an entity could designate as the hedged risk the variability in cash flows attributable to the contractually specified interest rate. By eliminating the concept of benchmark interest rates for hedges of variable-rate instruments in current GAAP, the amendments remove the requirement to designate only the overall variability in cash flows as the hedged risk in a cash flow hedge of a variable-rate instrument indexed to a nonbenchmark interest rate.
3. For a fair value hedge of interest rate risk, the amendments add the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate as an eligible benchmark interest rate in the United States in addition to those already permitted under current GAAP (the U.S. Treasury Rate, the London Interbank Offered Rate [LIBOR] Swap Rate, and the Fed Funds Effective Swap Rate [or Overnight Index Swap Rate]). This allows an entity that issues or invests in fixed-rate tax-exempt financial instruments to designate as the hedged risk changes in fair value attributable to interest rate risk related to the SIFMA Municipal Swap Rate rather than overall changes in fair value.

Accounting for the Hedged Item in Fair Value Hedges of Interest Rate Risk

In some cases, current GAAP contains limitations on how an entity can designate the hedged item in a fair value hedge of interest rate risk. In other cases, current GAAP contains limitations on how an entity can measure changes in fair value of the hedged item attributable to interest rate risk in certain fair value hedging relationships. Those limitations may not align with an entity's risk management

strategies or the way in which interest rate risk can be hedged in the cash flow hedging model. To resolve those issues, the amendments in this Update change the guidance for designating fair value hedges of interest rate risk and for measuring the change in fair value of the hedged item in fair value hedges of interest rate risk. Specifically, the amendments:

1. Permit an entity to measure the change in fair value of the hedged item on the basis of the benchmark rate component of the contractual coupon cash flows determined at hedge inception, rather than on the full contractual coupon cash flows as required by current GAAP.
2. Permit an entity to measure the hedged item in a partial-term fair value hedge of interest rate risk by assuming the hedged item has a term that reflects only the designated cash flows being hedged. Current GAAP does not allow this methodology when calculating the change in the fair value of the hedged item attributable to interest rate risk.
3. For prepayable financial instruments, permit an entity to consider only how changes in the benchmark interest rate affect a decision to settle a debt instrument before its scheduled maturity in calculating the change in the fair value of the hedged item attributable to interest rate risk.
4. For a closed portfolio of prepayable financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, permit an entity to designate an amount that is not expected to be affected by prepayments, defaults, and other events affecting the timing and amount of cash flows (the “last-of-layer” method). Under this designation, prepayment risk is not incorporated into the measurement of the hedged item.

Recognition and Presentation of the Effects of Hedging Instruments

The Board determined that achieving the objective of better portraying the economic results of an entity's risk management activities in its financial statements can be accomplished only through a combination of changes to the designation and measurement guidance for qualifying hedging relationships and the method of presenting hedge results. Therefore, in addition to the amendments to the designation and measurement guidance for qualifying hedging relationships, the amendments in this Update also align the recognition and presentation of the effects of the hedging instrument and the hedged item in the financial statements to increase the understandability of the results of an entity's intended hedging strategies.

The amendments in this Update require an entity to present the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is reported. This presentation enables users of financial statements to better understand the results and costs of an entity's hedging program. Also, relative to current GAAP, this approach simplifies the

financial statement reporting for qualifying hedging relationships. 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. However, the concept and reporting of hedge ineffectiveness were difficult for financial statement users to understand and, at times, for preparers to explain. Thus, the Board decided on an approach that no longer separately measures and reports hedge ineffectiveness.

To accomplish that objective, the amendments in this Update require the following recognition and presentation guidance for qualifying hedges:

1. For fair value hedges, the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness is presented in the same income statement line that is used to present the earnings effect of the hedged item. The timing of recognition of the change in fair value of a hedging instrument included in the assessment of hedge effectiveness is the same as under current GAAP, but the presentation of hedge results could change because current GAAP does not specify a required presentation of the change in fair value of the hedging instrument.
2. For cash flow and net investment hedges, the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness is recorded in other comprehensive income (for cash flow hedges) or in the currency translation adjustment section of other comprehensive income (for net investment hedges). Those amounts are reclassified to earnings in the same income statement line item that is used to present the earnings effect of the hedged item when the hedged item affects earnings. The timing of recognition of the change in fair value of a hedging instrument could change relative to current GAAP because hedge ineffectiveness no longer is recognized currently in earnings. The presentation of hedge results also could change because current GAAP does not specify a required presentation of the change in fair value of the hedging instrument in the income statement.

Amounts Excluded from the Assessment of Hedge Effectiveness

Current GAAP permits an entity to exclude option premiums and forward points from the assessment of hedge effectiveness. The amendments in this Update continue to allow an entity to exclude those components of a hedging instrument’s change in fair value from the assessment of hedge effectiveness. Additionally, the amendments permit an entity to exclude the portion of the change in fair value of a currency swap that is attributable to a cross-currency basis spread from the assessment of hedge effectiveness.

For all types of hedges, if an entity excludes certain portions of a hedging instrument's change in fair value from the assessment of hedge effectiveness (excluded component), the amendments permit an entity to recognize in earnings the initial value of the excluded component using a systematic and rational method over the life of the hedging instrument. If an entity elects this method, any difference between the change in fair value of the excluded component and amounts recognized under the systematic and rational method is recognized in other comprehensive income, whereas for net investment hedges, the difference is recognized in the cumulative translation adjustment section of other comprehensive income. An entity also may elect to recognize all fair value changes in an excluded component currently in earnings, consistent with current GAAP.

For fair value and cash flow hedges, an entity should present amounts related to excluded components that are recognized in earnings in the same income statement line item that is used to present the earnings effect of the hedged item. For net investment hedges, the amendments do not specify a required presentation for excluded components.

Other Simplifications of Hedge Accounting Guidance

The amendments in this Update also include certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness. Current GAAP contains specific requirements for initial and ongoing quantitative hedge effectiveness testing and strict requirements for specialized effectiveness testing methods that allow an entity to forgo quantitative hedge effectiveness assessments for qualifying relationships (for example, "shortcut" method and "critical terms match" method). The amendments change effectiveness testing as follows:

1. In instances in which initial quantitative testing is required, an entity may perform subsequent assessments of hedge effectiveness qualitatively. An entity that makes this election is required to verify and document on a quarterly basis that the facts and circumstances related to the hedging relationship have not changed such that the entity can assert qualitatively that the hedging relationship was and continues to be highly effective. An entity may elect to perform qualitative assessments on a hedge-by-hedge basis.
2. For purposes of assessing whether the qualifying criteria for the critical terms match method are met for a group of forecasted transactions, an entity may assume that the hedging derivative matures at the same time as the forecasted transactions if both the derivative maturity and the forecasted transactions occur within the same 31-day period or fiscal month.
3. Entities will be able to perform the initial prospective quantitative assessment of hedge effectiveness at any time after hedge designation,

- but no later than the first quarterly effectiveness testing date, using data applicable as of the date of hedge inception.
4. To provide additional relief on the timing of hedge documentation, private companies that are not financial institutions and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) may select the method of assessing hedge effectiveness, and perform the initial quantitative effectiveness assessment and all quarterly hedge effectiveness assessments before the date on which the next interim (if applicable) or annual financial statements are available to be issued. This incremental relief does not affect the simplified hedge accounting approach for private companies.
 5. If an entity that applies the shortcut method determines that use of that method was not or no longer is appropriate, the entity may apply a long-haul method for assessing hedge effectiveness as long as the hedge is highly effective and the entity documents at inception which long-haul methodology it will use.

Disclosures

Given the Board's revised view on presentation of hedging activities, the amendments in this Update modify disclosures required in current GAAP. Those modifications include a tabular disclosure related to the effect on the income statement of fair value and cash flow hedges and eliminate the requirement to disclose the ineffective portion of the change in fair value of hedging instruments. The amendments also require new tabular disclosures related to cumulative basis adjustments for fair value hedges.

Why Are the Amendments an Improvement?

The amendments in this Update more closely align the results of cash flow and fair value hedge accounting with risk management activities through changes to both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results in the financial statements. The amendments address specific limitations in current GAAP by expanding hedge accounting for both nonfinancial and financial risk components and by refining the measurement of hedge results to better reflect an entity's hedging strategies. Thus, the amendments will enable an entity to report more faithfully the economic results of hedging activities for certain fair value and cash flow hedges and will avoid mismatches in earnings by allowing for greater precision when measuring changes in fair value of the hedged item for certain fair value hedges. Additionally, by aligning the timing of recognition of hedge results with the earnings effect of the hedged item for cash flow and net investment hedges, and by including the earnings effect of the hedging instrument in the same income statement line item in which the earnings effect of the hedged item is presented, the results of an

entity's hedging program and the cost of executing that program will be more visible to users of financial statements. Overall, those amendments are an improvement because an entity's financial statements will reflect more accurately and comprehensively the intent and outcome of its hedging strategies.

The tabular disclosure related to effects on the income statement of fair value and cash flow hedges and the disclosure of cumulative basis adjustments for fair value hedges provide users with a more complete picture of the effect of hedge accounting on an entity's income statement and balance sheet. When considered together, the amendments to presentation and disclosures are an improvement because they will provide users with more decision-useful information about the effect of an entity's risk management activities on the financial statements.

Additionally, the amendments in this Update should ease the operational burden of applying hedge accounting by allowing more time to prepare hedge documentation and, allowing effectiveness assessments to be performed on a qualitative basis after hedge inception.

When Will the Amendments Be Effective?

For public business entities, the amendments in this Update are effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Early application is permitted in any interim period after issuance of the Update. All transition requirements and elections should be applied to hedging relationships existing (that is, hedging relationships in which the hedging instrument has not expired, been sold, terminated, or exercised or the entity has not removed the designation of the hedging relationship) on the date of adoption. The effect of adoption should be reflected as of the beginning of the fiscal year of adoption (that is, the initial application date).

Transition Requirements

For cash flow and net investment hedges existing at the date of adoption, an entity should apply a cumulative-effect adjustment related to eliminating the separate measurement of ineffectiveness to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the beginning of the fiscal year that an entity adopts the amendments in this Update. The amended presentation and disclosure guidance is required only prospectively.

Transition Elections

An entity may make certain transition elections upon adoption of the amendments. See paragraph 815-20-65-3 for additional details about those elections and the time frames in which they must be made.

Amendments to the *FASB Accounting Standards Codification*[®]

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–41. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Add the following new Master Glossary terms, with a link to transition paragraph 815-20-65-3, as follows:

Contractually Specified Component

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.

Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate

The fixed rate on a U.S. dollar, constant-notional interest rate swap that has its variable-rate leg referenced to the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index with no additional spread over the SIFMA Municipal Swap Index on that variable-rate leg. That fixed rate is the derived rate that would result in the swap having a zero fair value at inception because the present value of fixed cash flows, based on that rate, equates to the present value of the variable cash flows.

3. Amend the following Master Glossary terms, with a link to transition paragraph 815-20-65-3, as follows:

Auction Rate Notes

Auction rate notes are notes that generally have long-term nominal maturities and interest rates that reset periodically through a Dutch auction process, typically every 7, 28, or 35 days. At an auction, existing holders of auction rate notes and potential buyers enter a competitive bidding process through a broker-dealer, specifying the number of shares (units) to purchase with the lowest interest rate they are willing to accept. Generally, the lowest bid rate at which all shares can be sold at the notes' par value establishes the interest rate (also known as the clearing rate) to be applied until the next auction. ~~Auction rate notes are an example of a variable-rate financial instrument whose interest rate is not explicitly based on a benchmark rate.~~

Credit Risk

For purposes of a hedged item in a fair value hedge, credit risk is the risk of changes in the hedged item's fair value attributable to both of the following:

- a. Changes in the obligor's creditworthiness
- b. Changes in the spread over the {add glossary link}benchmark interest rate{add glossary link} with respect to the hedged item's credit sector at inception of the hedge.

For purposes of a hedged transaction in a cash flow hedge, credit risk is the risk of changes in the hedged transaction's cash flows attributable to all of the following:

- a. Default
- b. Changes in the obligor's creditworthiness
- c. Changes in the spread over the contractually specified interest rate or the benchmark interest rate with respect to the related financial asset's or liability's credit sector at inception of the hedge.

Interest Rate Risk

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. The risk of changes in a hedged item's fair value or cash flows attributable to changes in the designated benchmark interest rate.

Amendments to Subtopic 220-10

4. Amend paragraph 220-10-45-10A, with a link to transition paragraph 815-20-65-3, as follows:

Comprehensive Income—Overall

Other Presentation Matters

> > Items within Other Comprehensive Income

220-10-45-10A Items of other comprehensive income include the following:

- a. Foreign currency translation adjustments (see paragraph 830-30-45-12)
- b. Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date (see paragraph 830-20-35-3(a))
- c. Gains and losses on intra-entity foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting entity's financial statements (see paragraph 830-20-35-3(b))
- d. Gains and losses ~~(effective portion)~~ on derivative instruments that are designated as, and qualify as, cash flow hedges (see paragraph 815-20-35-1(c))
- dd. For derivatives that are designated in qualifying hedging relationships, the difference between changes in fair value of the excluded components and the initial value of the excluded components recognized in earnings under a systematic and rational method in accordance with paragraphs 815-20-25-83A and 815-35-35-5A
- e. Unrealized holding gains and losses on available-for-sale debt securities (see paragraph 320-10-45-1)
- f. Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category (see paragraph 320-10-35-10(c))
- g. Amounts recognized in other comprehensive income for debt securities classified as available-for-sale and held-to-maturity related to an other-than-temporary impairment recognized in accordance with Section 320-10-35 if a portion of the impairment was not recognized in earnings
- h. Subsequent decreases (if not an other-than-temporary impairment) or increases in the fair value of available-for-sale debt securities previously written down as impaired (see paragraph 320-10-35-18)

- i. Gains or losses associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j))
- j. Prior service costs or credits associated with pension or other postretirement benefits (see paragraph 715-20-50-1(j))
- k. Transition assets or obligations associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j)).
- l. Changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected (see paragraph 825-10-45-5).

Additional classifications or additional items within current classifications may result from future accounting standards.

In addition, amend the following pending content for paragraph 220-10-45-10A, with a link to transition paragraph 326-10-65-1:

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2020* | **Transition Guidance:** 326-10-65-1

220-10-45-10A Items of other comprehensive income include the following:

- a. Foreign currency translation adjustments (see paragraph 830-30-45-12)
- b. Gains and losses on foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date (see paragraph 830-20-35-3(a))
- c. Gains and losses on intra-entity foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting entity's financial statements (see paragraph 830-20-35-3(b))
- d. Gains and losses ~~(effective portion)~~ on derivative instruments that are designated as, and qualify as, cash flow hedges (see paragraph 815-20-35-1(c))
- dd. For derivatives that are designated in qualifying hedging relationships, the difference between changes in fair value of the excluded components and the initial value of the excluded components recognized in earnings under a systematic and rational method in accordance with paragraphs 815-20-25-83A and 815-35-35-5A
- e. Unrealized **holding gains and losses** on available-for-sale debt securities (see paragraph 326-30-35-2)

- f. Unrealized holding gains and losses that result from a debt security being transferred into the available-for-sale category from the held-to-maturity category (see paragraph 320-10-35-10(c))
- g. Subparagraph superseded by Accounting Standards Update No. 2016-13.
- h. Subparagraph superseded by Accounting Standards Update No. 2016-13.
- i. Gains or losses associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j))
- j. Prior service costs or credits associated with pension or other postretirement benefits (see paragraph 715-20-50-1(j))
- k. Transition assets or obligations associated with pension or other postretirement benefits (that are not recognized immediately as a component of net periodic benefit cost) (see paragraph 715-20-50-1(j)).
- l. Changes in fair value attributable to instrument-specific credit risk of liabilities for which the fair value option is elected (see paragraph 825-10-45-5).

Additional classifications or additional items within current classifications may result from future accounting standards.

Amendments to Subtopic 320-10

5. Amend paragraphs 320-10-35-1 and 320-10-45-8, with a link to transition paragraph 815-20-65-3, as follows:

Investments—Debt and Equity Securities—Overall

Subsequent Measurement

320-10-35-1 Investments in **debt securities** shall be measured subsequently as follows:

- a. **Trading securities.** Investments in debt securities that are classified as **trading** shall be measured subsequently at **fair value** in the statement of financial position. Unrealized **holding gains and losses** for trading securities shall be included in earnings.
- b. **Available-for-sale securities.** Investments in debt securities that are classified as available for sale shall be measured subsequently at fair value in the statement of financial position. Unrealized holding gains and losses for available-for-sale securities (including those classified as current assets) shall be excluded from earnings and reported in other comprehensive income until realized except as indicated in the following sentence. All or a portion of the unrealized holding gain and loss of an

available-for-sale security that is designated as being hedged in a fair value hedge shall be recognized in earnings during the period of the hedge, pursuant to paragraphs 815-25-35-1 and 815-25-35-4 through 35-4.

- c. Held-to-maturity securities. Investments in debt securities classified as held to maturity shall be measured subsequently at amortized cost in the statement of financial position. A transaction gain or loss on a held-to-maturity foreign-currency-denominated debt security shall be accounted for pursuant to Subtopic 830-20.

Other Presentation Matters

320-10-45-8 Paragraph 320-10-35-1 explains that all or a portion of the unrealized holding gain and loss of an available-for-sale security that is designated as being hedged in a fair value hedge shall be recognized in earnings during the period of the hedge, pursuant to paragraphs 815-25-35-1 and 815-25-35-4 through 35-4.

Amendments to Subtopic 815-10

6. Amend paragraphs 815-10-50-1B, 815-10-50-3, 815-10-50-4A, 815-10-50-4C through 50-4F and add paragraphs 815-10-50-4CC through 50-4CCC, 815-10-50-4EE through 50-4EEEE, and 815-10-50-5A through 50-5B and the related heading, with a link to transition paragraph 815-20-65-3, as follows:

Derivatives and Hedging—Overall

Disclosure

815-10-50-1 An entity with **derivative instruments** (or nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) shall disclose information to enable users of the financial statements to understand all of the following:

- a. How and why an entity uses derivative instruments (or such nonderivative instruments)
- b. How derivative instruments (or such nonderivative instruments) and related hedged items are accounted for under Topic 815
- c. How derivative instruments (or such nonderivative instruments) and related hedged items affect all of the following:
 1. An entity's financial position
 2. An entity's financial performance
 3. An entity's cash flows.

815-10-50-1A An entity that holds or issues derivative instruments (or nonderivative instruments that are designated and qualify as hedging instruments

pursuant to paragraphs 815-20-25-58 and 815-20-25-66) shall disclose all of the following for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented:

- a. Its objectives for holding or issuing those instruments
- b. The context needed to understand those objectives
- c. Its strategies for achieving those objectives
- d. Information that would enable users of its financial statements to understand the volume of its activity in those instruments.

815-10-50-1B For item (d) in ~~the preceding~~ paragraph 815-10-50-1A, an entity shall select the format and the specifics of disclosures relating to its volume of such activity that are most relevant and practicable for its individual facts and circumstances. Information about the instruments in items (a) through (c) in ~~the preceding~~ paragraph 815-10-50-1A shall be disclosed in the context of each instrument's primary underlying risk exposure (for example, interest rate, credit, foreign exchange rate, interest rate and foreign exchange rate, or overall price). Further, those instruments shall be distinguished between those used for risk management purposes and those used for other purposes. Derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) used for risk management purposes include those designated as hedging instruments under Subtopic 815-20 as well as those used as economic hedges and for other purposes related to the entity's risk exposures.

815-10-50-2 The instruments addressed by items (a) through (c) in paragraph 815-10-50-1A shall be distinguished between each of the following:

- a. Derivative instruments (and nonderivative instruments as noted in items (1)(i) and (1)(iii) of this paragraph) used for risk management purposes, distinguished between each of the following:
 1. Derivative instruments (and nonderivative instruments) designated as hedging instruments, distinguished between each of the following:
 - i. Derivative instruments (and nonderivative instruments) designated as fair value hedging instruments
 - ii. Derivative instruments designated as cash flow hedging instruments
 - iii. Derivative instruments (and nonderivative instruments) designated as hedging instruments for hedges of the foreign currency exposure of a net investment in a foreign operation.
 2. Derivative instruments used as economic hedges and for other purposes related to the entity's risk exposures.
- b. Derivative instruments used for other purposes.

815-10-50-3 If the simplified hedge accounting approach (see paragraphs 815-20-25-133 through 25-138 ~~815-20-25-131AB through 25-131E~~) is applied in

accounting for a qualifying receive-variable, pay-fixed interest rate swap, the settlement value of that swap may be used in place of **fair value** when disclosing the information required by this Section or in providing other fair value disclosures, such as those required under Topic 820 on fair value. For the purposes of complying with these disclosure requirements, amounts disclosed at settlement value will be subject to all of the same disclosure requirements as amounts disclosed at fair value. Any amounts disclosed at settlement value shall be clearly stated as such and disclosed separately from amounts disclosed at fair value.

815-10-50-4 For derivative instruments not designated as hedging instruments under Subtopic 815-20, the description shall indicate the purpose of the derivative activity.

> Overall Quantitative Disclosures

815-10-50-4A An entity that holds or issues derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) shall disclose all of the following for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented:

- a. The location and fair value amounts of derivative instruments (and such nonderivative instruments) reported in the statement of financial position
- b. The location and amount of the gains and losses on derivative instruments (and such nonderivative instruments) and related hedged items reported in any of the following:
 1. The statement of financial performance
 2. The statement of financial position (for example, gains and losses initially recognized in **other comprehensive income**).
- c. The total amount of each income and expense line item presented in the statement of financial performance in which the results of fair value or cash flow hedges are recorded.

815-10-50-4B The disclosures required by item (a) in the preceding paragraph shall comply with all of the following:

- a. The fair value of derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) shall be presented on a gross basis, even when those instruments are subject to master netting arrangements and qualify for net presentation in the statement of financial position in accordance with Subtopic 210-20.
- b. Cash collateral payables and receivables associated with those instruments shall not be added to or netted against the fair value amounts.

- c. Fair value amounts shall be presented as separate asset and liability values segregated between each of the following:
 - 1. Those instruments designated and qualifying as hedging instruments under Subtopic 815-20, presented separately by type of contract (for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, other contracts, and so forth)
 - 2. Those instruments not designated as hedging instruments, presented separately by type of contract.
- d. The disclosure shall identify the line item(s) in the statement of financial position in which the fair value amounts for these categories of derivative instruments are included.

Amounts required to be reported for nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66 shall be the carrying value of the nonderivative hedging instrument, which includes the adjustment for the foreign currency transaction gain or loss on that instrument.

815-10-50-4C The For qualifying fair value and cash flow hedges, the gains and losses disclosed pursuant to paragraph 815-10-50-4A(b) shall be presented separately for all of the following by type of contract (as discussed in the following paragraph): paragraph 815-10-50-4D) and by income and expense line item (if applicable):

- a. Derivative instruments (and nonderivative instruments) designated and qualifying as hedging instruments in fair value hedges and related hedged items designated and qualifying in fair value hedges.
- b. The ~~effective portion of~~ gains and losses on derivative instruments ~~(and nonderivative instruments)~~ designated and qualifying in cash flow hedges ~~included in the assessment of effectiveness and not investment hedges that were~~ was recognized in other comprehensive income during the current period.
- bb. Amounts excluded from the assessment of effectiveness that were recognized in other comprehensive income during the period for which an amortization approach is applied in accordance with paragraph 815-20-25-83A.
- c. The ~~effective portion of~~ gains and losses on derivative instruments ~~(and nonderivative instruments)~~ designated and qualifying in cash flow hedges ~~and not investment hedges that are included in the assessment of effectiveness and recorded in accumulated other comprehensive income during the term of the hedging relationship and reclassified into earnings during the current period.~~
- d. The portion of gains and losses on derivative instruments ~~(and nonderivative instruments)~~ designated and qualifying in fair value and cash flow hedges ~~and not investment hedges~~ representing the amount, if

any, excluded from the assessment of hedge effectiveness that is recognized in earnings. When disclosing this amount, an entity shall disclose separately amounts that are recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A and amounts recognized through changes in fair value in earnings in accordance with paragraph 815-20-25-83B, any of the following:

1. Subparagraph superseded by Accounting Standards Update No. 2017-12. The amount of the hedges' ineffectiveness
 2. Subparagraph superseded by Accounting Standards Update No. 2017-12. The amount, if any, excluded from the assessment of hedge effectiveness.
- e. Subparagraph superseded by Accounting Standards Update No. 2017-12. Derivative instruments not designated or qualifying as hedging instruments under Subtopic 815-20 (see paragraph 815-10-50-4F).
- e. f. The amount of gains and losses reclassified into earnings as a result of the discontinuance of {remove glossary link}cash flow hedges{remove glossary link} because it is probable that the original forecasted transactions will not occur by the end of the originally specified time period or within the additional period of time discussed in paragraphs 815-30-40-4 through 40-5. [Content amended as shown and moved from paragraph 815-30-50-1(e)]
- g. The amount of net gain or loss recognized in earnings when a hedged firm commitment no longer qualifies as a fair value hedge. [Content moved from paragraph 815-25-50-1(b)]

Example 21 (see paragraph 815-10-55-182) illustrates the disclosure of fair value amounts of derivative instruments (and such nonderivative instruments) reported in the statement of financial position.

815-10-50-4CC An entity shall present separately by type of contract (as discussed in paragraph 815-10-50-4D) the gains and losses disclosed in accordance with paragraph 815-10-50-4A(b) for derivative instruments not designated or qualifying as hedging instruments under Topic 815 (see paragraph 815-10-50-4F).

815-10-50-4CCC For qualifying net investment hedges, an entity shall present the gains and losses disclosed in accordance with paragraph 815-10-50-4A(b) separately for all of the following by type of contract (as discussed in paragraph 815-10-50-4D):

- a. The gains and losses on derivative instruments (and nonderivative instruments) designated and qualifying in net investment hedges that were recognized in the cumulative translation adjustment section of other comprehensive income during the current period
- b. The gains and losses on derivative instruments (and nonderivative instruments) designated and qualifying in net investment hedges recorded in the cumulative translation adjustment section of accumulated

other comprehensive income during the term of the hedging relationship and reclassified into earnings during the current period

- c. The portion of gains and losses on derivative instruments (and nonderivative instruments) designated and qualifying in net investment hedges representing the amount, if any, excluded from the assessment of hedge effectiveness.

815-10-50-4D Disclosures pursuant to ~~the preceding paragraph~~ paragraphs 815-10-50-4C through 50-4CCC shall both:

- a. Be presented separately by type of contract, for example:
 1. Interest rate contracts
 2. Foreign exchange contracts
 3. Equity contracts
 4. Commodity contracts
 5. Credit contracts
 6. Other contracts.
- b. Identify the line item(s) in the statement of financial performance in which the gains and losses for these categories of derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) are included.

815-10-50-4E The quantitative disclosures required by paragraphs 815-10-50-4A through 50-4CCC ~~paragraph 815-10-50-4A(a) and 50-4A(b)~~ shall be presented in tabular format ~~except for the information required for hedged items by subparagraph 815-10-50-4C(a). Information about hedged items can be presented in a tabular or nontabular format. Example 20 (see paragraph 815-10-55-181) illustrates a nontabular presentation. Example 21 (see paragraph 815-10-55-182) illustrates the disclosure of fair value amounts of derivative instruments (and such nonderivative instruments) reported in the statement of financial performance. If a proportion of a derivative instrument is designated and qualifying as a hedging instrument and a proportion is not designated and qualifying as a hedging instrument, an entity shall allocate the related amounts to the appropriate categories within the disclosure table.~~ tables. Example 21 (see paragraph 815-10-55-182) illustrates the disclosures described in paragraphs 815-10-50-4A through 50-4E.

815-10-50-4EE An entity shall disclose in tabular format the following for items designated and qualifying as hedged items in fair value hedges:

- a. The carrying amount of hedged assets and liabilities recognized in the statement of financial position
- b. The cumulative amount of fair value hedging adjustments to hedged assets and liabilities included in the carrying amount of the hedged assets and liabilities recognized in the statement of financial position

- c. The line item in the statement of financial position that includes the hedged assets and liabilities
- d. The cumulative amount of fair value hedging adjustments remaining for any hedged assets and liabilities for which hedge accounting has been discontinued.

815-10-50-4EEE For each line item disclosed in accordance with paragraph 815-10-50-4EE(c) that includes hedging relationships designated under the last-of-layer method in accordance with paragraph 815-20-25-12A, the following information shall be disclosed separately:

- a. The amortized cost basis of the closed portfolio(s) of prepayable financial assets or the beneficial interest(s)
- b. The amount that represents the hedged item(s) (that is, the designated last of layer)
- c. The basis adjustment associated with the hedged item(s) (that is, the designated last of layer).

Example 20 (see paragraph 815-10-55-181) illustrates these disclosures.

815-10-50-4EEEE If an entity elects to record changes in the fair value of amounts excluded from the assessment of effectiveness currently in earnings in accordance with paragraph 815-20-25-83B, the entity shall disclose this election in its summary of significant accounting policies.

> > Trading Derivatives

815-10-50-4F For derivative instruments that are not designated or qualifying as hedging instruments under Subtopic 815-20, if an entity's policy is to include those derivative instruments in its trading activities (for example, as part of its trading portfolio that includes both derivative instruments and nonderivative or cash instruments), the entity can elect to not separately disclose gains and losses as required by paragraph 815-10-50-4CC ~~815-10-50-4C(e)~~ provided that the entity discloses all of the following:

- a. The gains and losses on its trading activities (including both derivative instruments and nonderivative instruments) recognized in the statement of financial performance, separately by major types of items, for example:
 1. Fixed income/interest rates
 2. Foreign exchange
 3. Equity
 4. Commodity
 5. Credit.
- b. The line items in the statement of financial performance in which trading activities gains and losses are included

- c. A description of the nature of its trading activities and related risks, and how the entity manages those risks.

If the disclosure option in this paragraph is elected, the entity shall include a footnote in the required tables referencing the use of alternative disclosures for trading activities. Example 21 (see paragraph 815-10-55-182) illustrates a footnote referencing the use of alternative disclosures for trading activities. Example 22 (see paragraph 815-10-55-184) illustrates the disclosure of the information required in items (a) and (b).

> Qualitative Disclosures

815-10-50-5 Qualitative disclosures about an entity's objectives and strategies for using derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 815-20-25-58 and 815-20-25-66) may be more meaningful if such objectives and strategies are described in the context of an entity's overall risk exposures relating to all of the following:

- a. Interest rate risk
- b. Foreign exchange risk
- c. Commodity price risk
- d. Credit risk
- e. Equity price risk.

Those additional qualitative disclosures, if made, should include a discussion of those exposures even though the entity does not manage some of those exposures by using derivative instruments. An entity is encouraged, but not required, to provide such additional qualitative disclosures about those risks and how they are managed.

~~**815-10-50-5A** For guidance on qualitative disclosures, see paragraph 815-10-50-5. The quantitative disclosures about derivative instruments may be more useful, and less likely to be perceived to be out of context or otherwise misunderstood, if similar information is disclosed about other financial instruments or nonfinancial assets and liabilities to which the derivative instruments are related by activity. Accordingly, in those situations, an entity is encouraged, but not required, to present a more complete picture of its activities by disclosing that information. [Content amended as shown and moved from paragraph 815-35-50-2]~~

> Basis Adjustment Considerations under the Last-of-Layer Method

815-10-50-5B For hedging relationships designated under the last-of-layer method, an entity may need to allocate the outstanding basis adjustment to meet the objectives of disclosure requirements in other Topics. For purposes of those disclosure requirements, the entity may allocate the basis adjustment on an individual asset basis or on a portfolio basis using a systematic and rational method.

7. Amend paragraphs 815-10-55-181 through 55-182 and the related heading, with a link to transition paragraph 815-20-65-3, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > **Example 20: Disclosure of Qualitative Information by Underlying Risk and Fair Value Hedge Basis Adjustment Disclosures**

815-10-55-181 This Example illustrates the disclosure of objectives and strategies for using derivative instruments by underlying risk, including volume of activity (see paragraph 815-10-50-1A(d)). It also illustrates the fair value hedge basis adjustment disclosures in paragraphs 815-10-50-4EE through 50-4EEE. ~~815-10-50-1(d)), and also includes a nontabular presentation of the quantitative information about the hedged items in fair value hedges (see paragraph 815-10-50-4C(a)).~~

The Entity is exposed to certain risks relating to its ongoing business operations. The primary risks managed by using derivative instruments are commodity price risk and interest rate risk. Forward contracts on various commodities are entered into to manage the price risk associated with forecasted purchases of materials used in the Entity's manufacturing process. Interest rate swaps are entered into to manage interest rate risk associated with fixed-rate loans issued by the Entity's financing subsidiary ~~the Entity's fixed-rate borrowings~~.

FASB ASC 815-10 requires that an entity recognize all derivative instruments as either assets or liabilities at fair value in the statement of financial position. In accordance with that Subtopic, the Entity designates commodity forward contracts as cash flow hedges of forecasted purchases of commodities and interest rate swaps as fair value hedges of fixed-rate receivables ~~borrowings~~.

Cash flow hedges

For derivative instruments that are designated and qualify as a cash flow hedge, ~~the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings and is presented in the same income statement line item as the earnings effect of the hedged item.~~ Gains and losses on the derivative instrument representing ~~either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized currently in current earnings and are presented in the same line of the income statement expected for the hedged item.~~

As of December 31, 20X2, ~~20XX~~, the Entity had the following outstanding commodity forward contracts that were entered into to hedge forecasted purchases:

<u>Commodity</u>	<u>Number of Bushels (000s)</u>
Wheat	XX,XXX <u>10,000</u>
Corn	XX,XXX <u>20,000</u>
Oats	XXX <u>15,000</u>

Fair value hedges

For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk are recognized in current earnings. The Entity includes the gain or loss on the hedged items (that is, fixed-rate ~~receivables~~ borrowings) in the same line item—interest ~~income~~ expense—as the offsetting loss or gain on the related interest rate ~~swaps~~ swaps as follows:

<u>Income Statement Classification</u>	<u>Gain/(Loss) on Swaps</u>	<u>Gain/(Loss) on Borrowings</u>
Interest expense	\$(XXX)	\$(XXX)

As of December 31, 20X2, and 20X1, the following amounts were recorded on the balance sheet related to cumulative basis adjustments for fair value hedges.

[For ease of readability, the new table is not underlined.]

<u>Line Item in the Statement of Financial Position in Which the Hedged Item Is Included</u>	<u>Carrying Amount of the Hedged Assets/(Liabilities)</u>		<u>Cumulative Amount of Fair Value Hedging Adjustment Included in the Carrying Amount of the Hedged Assets/(Liabilities)</u>	
	<u>20X2</u>	<u>20X1</u>	<u>20X2</u>	<u>20X1</u>
Loans receivable ^(a)	\$115	\$124	\$10 ^(b)	\$20

(a) These amounts include the amortized cost basis of closed portfolios used to designate hedging relationships in which the hedged item is the last layer expected to be remaining at the end of the hedging relationship. At December 31, 20X2 and 20X1, the amortized cost basis of the closed portfolios used in these hedging relationships was \$52 and \$60, respectively, the cumulative basis adjustments associated with these hedging relationships was \$5 and \$7, respectively, and the amounts of the designated hedged items were \$16 and \$18, respectively.

(b) The balance includes \$2 of hedging adjustment on a discontinued hedging relationship.

As of December 31, 20X2 and 20X1 ~~20XX~~, the total notional amount of the Entity's ~~receive-fixed/pay-variable~~ pay-fixed/receive-variable interest rate swaps was \$79 and \$82, respectively ~~XXX~~ million.

> > Example 21: Tabular Disclosures of Derivative Instruments

815-10-55-182 This Example illustrates the disclosure in tabular format of fair value amounts of derivative instruments and gains and losses on derivative instruments as required by paragraphs 815-10-50-4A through 50-4E. ~~815-10-50-4D~~:

In millions of dollars
As of December 31

Fair Values of Derivative Instruments

	Derivative Assets			Derivative Liabilities		
	2010			2009		
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments under Subtopic 815-20 FASB-ASC 815-20						
Interest rate contracts	Other assets	\$XX,XXX	Other assets	\$XX,XXX	Other liabilities	\$XX,XXX
Foreign exchange contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Commodity contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Credit contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Other contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Total derivatives designated as hedging instruments under Subtopic 815-20		\$XX,XXX		\$XX,XXX		\$XX,XXX
Derivatives not designated as hedging instruments under Subtopic 815-20^(a)						
Interest rate contracts	Other assets	\$XX,XXX	Other assets	\$XX,XXX	Other liabilities	\$XX,XXX
Foreign exchange contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Equity contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Commodity contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Credit contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Other contracts	Other assets	XX,XXX	Other assets	XX,XXX	Other liabilities	XX,XXX
Total derivatives not designated as hedging instruments under Subtopic 815-20		\$XX,XXX		\$XX,XXX		\$XX,XXX
Total derivatives		\$XX,XXX		\$XX,XXX		\$XX,XXX

(a) See note XX for additional information on the ABC Entity's purpose for entering into derivative instruments **not** designated as hedging instruments and its overall risk management strategies.

The Effect of Fair Value and Cash Flow Hedge Accounting on Accumulated Other Comprehensive Income Derivative Instruments on the Statement of Financial Performance for the Years Ended December 31, 2010 and 2009

Derivatives in Subtopic 815-20 Fair Value Hedging Relationships	Location of Gain or (Loss) Recognized in Income on Derivative ^(a)	Amount of Gain or (Loss) Recognized in Income on Derivative		Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion) ^(a)	Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion and Amount Excluded from Effectiveness Testing) ^(a)	Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective Portion and Amount Excluded from Effectiveness Testing) ^(a)	
		2010	2009			2010	2009
Derivatives in Subtopic 815-20 Cash Flow Hedging Relationships							
Derivatives in Cash Flow Hedging Relationships							
Interest rate contracts	Interest Income/(expense)	\$XX,XXX	\$XX,XXX	\$XX,XXX	Other Income/(expense)	\$XX,XXX	\$XX,XXX
Foreign exchange contracts	Foreign currency gain/(loss)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Equity contracts	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Commodity contracts	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Credit derivatives	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Other contracts	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Total		\$XX,XXX	\$XX,XXX	\$XX,XXX		\$XX,XXX	\$XX,XXX
Derivatives in Subtopic 815-20 Cash Flow Hedging Relationships							
Derivatives in Cash Flow Hedging Relationships							
Interest rate contracts	Interest Income/(expense)	\$XX,XXX	\$XX,XXX	\$XX,XXX	Other Income/(expense)	\$XX,XXX	\$XX,XXX
Foreign exchange contracts	Sales/Revenue	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Equity contracts	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Commodity contracts	Cost of sales	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Credit derivatives	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Other contracts	Other Income/(expense)	XX,XXX	XX,XXX	XX,XXX	Other Income/(expense)	XX,XXX	XX,XXX
Total		\$XX,XXX	\$XX,XXX	\$XX,XXX		\$XX,XXX	\$XX,XXX

Derivatives in Fair Value Hedging Relationships¹

Interest rate contracts	\$XX,XXX
Foreign exchange contracts	XX,XXX
Commodity contracts	XX,XXX
Credit derivatives	XX,XXX
Other contracts	XX,XXX
Total	\$XX,XXX

¹ Represents amounts excluded from the assessment of effectiveness for which the difference between changes in fair value and periodic amortization is recorded in other comprehensive income.

[For ease of readability, the new table is not underlined.]

The Effect of Fair Value and Cash Flow Hedge Accounting on the Statement of Financial Performance
for the Years Ended December 31, 20X1 and 20X0

	Location and Amount of Gain or (Loss) Recognized in Income on Fair Value and Cash Flow Hedging Relationships ⁽¹⁾							
	20X1				20X0			
	Revenue	Cost of Goods Sold	Interest Income (Expense)	Other Income (Expense)	Revenue	Cost of Goods Sold	Interest Income (Expense)	Other Income (Expense)
Total amounts of income and expense line items presented in the statement of financial performance in which the effects of fair value or cash flow hedges are recorded	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX
The effects of fair value and cash flow hedging:								
Gain or (loss) on fair value hedging relationships in Subtopic 815-20:								
Interest contracts:								
Hedged items	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives designated as hedging instruments	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commodity contracts:								
Hedged items	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives designated as hedging instruments	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on an amortization approach	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Foreign exchange contracts:								
Hedged items	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives designated as hedging instruments	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on an amortization approach	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Credit contracts:								
Hedged items	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives designated as hedging instruments	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on an amortization approach	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Gain or (loss) on cash flow hedging relationships in Subtopic 815-20:								
Interest contracts:								
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income as a result that a forecasted transaction is no longer probable of occurring	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commodity contracts:								
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on changes in fair value	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Foreign exchange contracts:								
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on changes in fair value	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Credit contracts:								
Amount of gain or (loss) reclassified from accumulated other comprehensive income into income	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Amount excluded from effectiveness testing recognized in earnings based on changes in fair value	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX	XX,XXX

Effect of Net Investment Hedges on Accumulated Other Comprehensive Income and the Statement of Financial Performance

Derivatives in Subtopic 815-20 Net Investment Hedging Relationships	Amount of Gain or (Loss) Recognized in Other Comprehensive Income on Derivative (Effective-Portion)		Location of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective-Portion)		Amount of Gain or (Loss) Reclassified from Accumulated Other Comprehensive Income into Income (Effective-Portion)		Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective-Portion and Amount Excluded from Effectiveness Testing) ^(a)		Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective-Portion and Amount Excluded from Effectiveness Testing) ^(a)	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX
Foreign exchange contracts										

Effect of Derivatives Not Designated as Hedging Instruments on the Statement of Financial Performance

Derivatives Not Designated as Hedging Instruments under Subtopic 815-20 ^{(b),(c)}	Location of Gain or (Loss) Recognized in Income on Derivative ^(a)		Amount of Gain or (Loss) Recognized in Income on Derivative	
	2010	2009	2010	2009
Interest rate contracts	Other income/(expense)		\$XX,XXX	\$XX,XXX
Foreign exchange contracts	Other income/(expense)		XX,XXX	XX,XXX
Equity contracts	Other income/(expense)		XX,XXX	XX,XXX
Commodity contracts	Other income/(expense)		XX,XXX	XX,XXX
Credit derivatives	Other income/(expense)		XX,XXX	XX,XXX
Other contracts	Other income/(expense)		XX,XXX	XX,XXX
Total			<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

- (a) If gains and losses associated with a type of contract (for example, interest rate contracts) are displayed in multiple line items in the income statement of financial performance, the entity is required to disclose the
- (b) See note XX for additional information on the ABC Entity's purpose for entering into derivative instruments not designated as hedging instruments and its overall risk management strategies.
- (c) For alternative disclosures about "trading derivatives," see separate table for trading activities in notes to financial statements.
- (d) Footnote superseded by Accounting Standards Update No. 2017-12. The amount of gain or (loss) recognized in income represents \$XXX related to the ineffective portion of the hedging relationships and \$XXX related to the amount excluded from the assessment of hedge effectiveness.

Amendments to Subtopic 815-20

8. Amend paragraphs 815-20-05-1 through 05-2 and supersede paragraphs 815-20-05-03 through 05-10 and their related headings, with a link to transition paragraph 815-20-65-3, as follows:

Derivatives and Hedging—Hedging—General

Overview and Background

815-20-05-1 The Derivatives and Hedging Topic includes several Subtopics on hedging activities:

- a. Hedging—General (Subtopic 815-20)
- b. Fair Value Hedges (Subtopics 815-20 and 815-25)
- c. Cash Flow Hedges (Subtopics 815-20 and 815-30)
- d. Net Investment Hedges (Subtopics 815-20 and 815-35).

815-20-05-2 This Subtopic provides general guidance applicable to all three types of hedging relationships: **fair value hedges**, **cash flow hedges**, and hedges of a net investment in a foreign operation. This Subtopic includes the basic guidance for qualifying for hedge accounting such as hedge documentation requirements, which types of risks are eligible for hedge accounting, and which items may or may not be designated as hedged items and hedging instruments. This Subtopic also provides guidance on hedge effectiveness criteria and assessments of hedge effectiveness. Financial statement presentation of the change in the **fair value** of a qualifying hedging instrument also is covered in this Subtopic. ~~This Subtopic provides guidance on accounting for and financial reporting of three types of hedging relationships: **fair value hedges**, **cash flow hedges**, and hedges of a net investment in a foreign operation.~~ The other three Subtopics of the Derivatives and Hedging Topic provide incremental guidance specific to the particular type of hedging relationship such as subsequent measurement and dedesignation of a hedging relationship. Implementation guidance and examples specific to fair value, cash flow, and net investment hedges are included in both Subtopic 815-20 and the specific Subtopics for each type of hedging relationship. Disclosure guidance for all hedging relationships is included in Section 815-10-50, and disclosure examples are included in Section 815-10-55. Incremental disclosure guidance for cash flow hedges is provided in Section 815-30-50.

> Interest Rate Swap in Arrears

815-20-05-3 Paragraph superseded by Accounting Standards Update No. 2017-12. The guidance beginning in paragraph 815-20-25-102 sets forth conditions that determine which hedging relationships involving interest rate swaps qualify for a shortcut version of hedge accounting that does not immediately recognize hedge ineffectiveness. Plain-vanilla interest rate swaps are contractual arrangements that require the periodic exchange of two cash flows (usually settled net)—one relating to an interest calculation involving a fixed interest rate, and the other relating to an interest calculation involving a floating interest rate. In plain-vanilla interest rate swaps, the fixed interest rate does not change, while the floating interest rate is determined (that is, reset) at the beginning of each period; thus, on that date, the scheduled net cash flow for the period will be known. The net cash flow does not actually occur, however, until the payment date, which is at the end of the period. That is, if the swap interest rates are reset every three months, the cash flows occur at the end of each three-month period based on the interest rates determined at the beginning of the three-month period. Thus, for plain-vanilla interest rate swaps, the floating interest rate is applied prospectively.

815-20-05-4 Paragraph superseded by Accounting Standards Update No. 2017-12. An interest rate swap in arrears works the same way as a plain-vanilla swap except that the floating interest rate for a swap in arrears is applied retrospectively. With an interest rate swap in arrears, the net cash flow occurs immediately at the interest rate reset date (which is at the end of the reset period). That is, if the swap interest rates are reset every three months, the cash flows occur at the end of each three-month period based on the interest rates determined at that same time applied to the three-month period just ended. Note that generally, both plain-vanilla swaps and swaps in arrears are initiated with **fair values** equal to zero. At any given time, however, there will be some difference between the fixed interest rates on the two respective swaps or between the variable interest rates on the two respective swaps unless the yield curve is perfectly flat. See paragraphs 815-20-25-106(d) through 25-107 for related guidance.

> Commercial Paper and Similar Instruments

815-20-05-5 Paragraph superseded by Accounting Standards Update No. 2017-12. This Subtopic includes guidance on hedging relationships involving commercial paper and similar instruments. Commercial paper and similar markets present an opportunity for highly rated borrowers, or those with high-quality collateral, to consistently obtain low-cost short-term financing. Similarly, investments in these instruments provide a high-quality short-term investment vehicle. Frequently, **derivative instruments** (typically interest rate swaps, or purchased caps or floors) are used to hedge the forecasted interest payments or receipts arising from future issuances or future investments.

815-20-05-6 Paragraph superseded by Accounting Standards Update No. 2017-12. Commercial paper and similar instruments are issued on a fixed rate discounted basis with relatively short contractual maturities (for example, from 7 to 270 days). That is, the issuer receives a single discounted amount as proceeds of the issuance and makes a single payment of the stated amount at maturity. There are no periodic interest payments; thus, these instruments are effectively zero-coupon instruments.

815-20-05-7 Paragraph superseded by Accounting Standards Update No. 2017-12. The interest rate is established for each issuer based on market conditions that exist at the time of issuance. Although commercial paper interest rate indexes exist, they represent the average rates paid by selected issuers at a point in time. In other cases, the depth of the markets and the consistency of collateral lead to very tight bid ask interest rate quotes. In any of these cases, however, the actual rate paid by any particular issuer reflects the market's perception of the liquidity, credit, and other risks that are unique to the issuer or the **transaction** on any given day.

815-20-05-8 Paragraph superseded by Accounting Standards Update No. 2017-12. Issuers and investors in commercial paper typically issue and invest in very large volumes and actively manage their funding programs. A typical commercial paper program will involve daily issuances of a broad range of maturities of paper so as to balance the objectives of achieving the lowest cost of funds and a target average maturity of the portfolio of outstanding commercial paper.

815-20-05-9 Paragraph superseded by Accounting Standards Update No. 2017-12. An entity with a rolling commercial paper program may wish to hedge the risk of changes in the interest element of the final cash flows at maturity attributable to changes in the **benchmark interest rate** related to each of the forecasted issuances of fixed rate commercial paper (that is, zero coupon instruments).

> CDs

815-20-05-10 Paragraph superseded by Accounting Standards Update No. 2017-12. This Subtopic includes guidance on hedging relationships involving certificates of deposit (CDs). CDs are an important source of funds for banks and savings institutions. CDs generally have a stipulated maturity and a fixed interest rate that is payable either periodically or at maturity. A bank with CDs may wish to hedge the risk of changes in the coupon payments (or the interest element of the final cash flow if interest is paid only at maturity) attributable to changes in the benchmark interest rate related to the forecasted issuance of fixed rate CDs. The interest rate of the CDs actually issued will be based on market conditions that exist at the time of issuance. Influences such as market appetite, the bank's liquidity and needs, and other CD rates at other banks may have an effect on the actual fixed interest rate on the date of issuance.

Objectives

815-20-10-1 Paragraph 815-10-10-1 states that one cornerstone underlying the guidance in this Topic is that special accounting for items designated as being hedged should be provided only for qualifying items. That paragraph explains that one aspect of qualification should be an assessment of the expectation of effective offsetting changes in **fair values** or cash flows during the term of the hedge for the risk being hedged.

Scope and Scope Exceptions

> Entities

815-20-15-1 The guidance in this Subtopic applies to all entities.

9. Amend paragraphs 815-20-25-1, 815-20-25-3, 815-20-25-6 through 25-6A, 815-20-25-12, 815-20-25-15, 815-20-25-16 through 25-17 and the related heading, 815-20-25-19, 815-20-25-36, 815-20-25-43, 815-20-25-46B, 815-20-25-50 through 25-51, 815-20-25-54, 815-20-25-72 through 25-73, 815-20-25-77, 815-20-25-79 through 25-86, 815-20-25-102 and its related heading, 815-20-25-104 through 25-106, 815-20-25-111, 815-20-25-113, 815-20-25-117, the heading preceding paragraph 815-20-25-118, 815-20-25-119, 815-20-25-125, and 815-20-25-129, add paragraphs 815-20-25-3A, 815-20-25-6B and its related heading, 815-20-25-12A, 815-20-25-19A through 25-19B, 815-20-25-22A through 25-22B and their related heading, 815-20-25-79A, 815-20-25-83A through 25-83B, 815-20-25-84A, 815-20-25-117A through 25-117D and their related heading, 815-20-25-118A and its related heading, 815-20-25-129A, and 815-20-25-133 through 25-143 and their related headings, and supersede paragraphs 815-20-25-131AA through 25-132 and their related headings, with a link to transition paragraph 815-20-65-3, as follows:

Recognition

815-20-25-1 This Section sets forth criteria that must be met for designated hedging instruments and hedged items or **transactions** to qualify for **fair value hedge** accounting, **cash flow hedge** accounting, and accounting for a hedge of a net investment in a foreign operation. The criteria are organized as follows:

- a. Formal designation and documentation at hedge inception
- b. Eligibility of hedged items and transactions
- c. Eligibility of hedging instruments
- d. Hedge effectiveness.
- e. Hedge accounting provisions applicable to certain private companies
- f. Hedge accounting provisions applicable to certain not-for-profit entities.

815-20-25-2 The guidance in this Section specifies whether a criterion applies to one or more types of hedging relationships. For example, paragraph 815-20-25-3(b)(1) is specified as a criterion that applies to fair value hedges, cash flow hedges, and net investment hedges.

> Formal Designation and Documentation at Hedge Inception

815-20-25-3 Concurrent designation and documentation of a hedge is critical; without it, an entity could retroactively identify a hedged item, a hedged **transaction**, or a method of assessing ~~measuring~~ effectiveness to achieve a desired accounting result. To qualify for hedge accounting, there shall be, at inception of the hedge, formal documentation of all of the following:

- a. Subparagraph not used
- b. Documentation requirement applicable to fair value hedges, cash flow hedges, and net investment hedges:
 1. The hedging relationship
 2. The entity's risk management objective and strategy for undertaking the hedge, including identification of all of the following:
 - i. The hedging instrument.
 - ii. The hedged item or transaction.
 - iii. The nature of the risk being hedged.
 - iv. The method that will be used to retrospectively and prospectively assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's **fair value** (if a fair value hedge) or hedged transaction's variability in cash flows (if a cash flow hedge) attributable to the hedged risk. There shall be a reasonable basis for how the entity plans to assess the hedging instrument's effectiveness.

01. An entity shall perform an initial prospective assessment of hedge effectiveness on a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) unless one of the following applies:

- A. In a cash flow or fair value hedge, the entity applies the shortcut method in accordance with paragraphs 815-20-25-102 through 25-117.
- B. In a cash flow or fair value hedge, the entity determines that the critical terms of the hedging instrument and the hedged item match in accordance with paragraphs 815-20-25-84 through 25-85.
- C. In a cash flow hedge, the hedging instrument is an option, and the conditions in paragraphs 815-20-25-126 and 815-20-25-129 through 25-129A are met.
- D. In a cash flow hedge, a **private company** that is not a financial institution as described in paragraph 942-

320-50-1 applies the simplified hedge accounting approach in paragraphs 815-20-25-133 through 25-138.

- E. In a cash flow hedge, the entity assesses hedge effectiveness under the change in variable cash flows method in accordance with paragraphs 815-30-35-16 through 35-24, and all of the conditions in paragraph 815-30-35-22 are met.
 - F. In a cash flow hedge, the entity assesses hedge effectiveness under the hypothetical derivative method in accordance with paragraphs 815-30-35-25 through 35-29, and all of the critical terms of the hypothetical derivative and hedging instrument are the same.
 - G. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in spot exchange rates, and the conditions in paragraph 815-35-35-5 (for derivative instruments) or 815-35-35-12 (for nonderivative instruments) are met.
 - H. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in forward exchange rates, and the conditions in paragraph 815-35-35-17A are met.
02. The initial prospective quantitative hedge effectiveness assessment using information applicable as of the date of hedge inception is considered to be performed concurrently at hedge inception if it is completed by the earliest of the following:
- A. The first quarterly hedge effectiveness assessment date
 - B. The date that financial statements that include the hedged transaction are available to be issued
 - C. The date that any criterion in Section 815-20-25 no longer is met
 - D. The date of expiration, sale, termination, or exercise of the hedging instrument
 - E. The date of dedesignation of the hedging relationship
 - F. For a cash flow hedge of a forecasted transaction (in accordance with paragraph 815-20-25-13(b)), the date that the forecasted transaction occurs.
03. An entity also shall document at hedge inception whether it elects to perform subsequent retrospective and prospective hedge effectiveness assessments on a qualitative basis and how it intends to carry out that qualitative assessment. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative

assessments of effectiveness. In addition, the entity shall document which quantitative method it will use if facts and circumstances of the hedging relationship change and the entity must quantitatively assess hedge effectiveness in accordance with paragraph 815-20-35-2D. An entity must document that it will perform the same quantitative assessment method for both initial and subsequent prospective hedge effectiveness assessments. The guidance in paragraphs 815-20-55-55 through 55-56 applies if the entity wants to change its quantitative method of assessing effectiveness after the initial quantitative effectiveness assessment.

04. An entity that applies the shortcut method in paragraphs 815-20-25-102 through 25-117 may elect to document at hedge inception a quantitative method to assess hedge effectiveness and measure hedge results if the entity determines at some point during the term of the hedging relationship that the use of the shortcut method was not or no longer is appropriate. See paragraphs 815-20-25-117A through 25-117D.
- v. ~~Subparagraph superseded by Accounting Standards Update No. 2017-12. The method that will be used to measure hedge ineffectiveness (including those situations in which the change in fair value method as described in paragraphs 815-30-35-34 through 35-32 will be used).~~
 - vi. If the entity is hedging foreign currency risk on an after-tax basis, that the assessment of effectiveness, ~~including the calculation of ineffectiveness,~~ will be on an after-tax basis (rather than on a pretax basis).
- c. Documentation requirement applicable to fair value hedges only:
- 1. For a fair value hedge of a **firm commitment**, a reasonable method for recognizing in earnings the asset or liability representing the gain or loss on the hedged firm commitment.
 - 2. For a hedging relationship designated under the last-of-layer method, an analysis to support the entity's expectation that the hedged item is anticipated to be outstanding as of the hedged item's assumed maturity date (see paragraph 815-20-25-12A(a) for additional guidance).
- d. Documentation requirement applicable to cash flow hedges only:
- 1. For a cash flow hedge of a **forecasted transaction**, documentation shall include all relevant details, including all of the following:
 - i. The date on or period within which the forecasted transaction is expected to occur.
 - ii. The specific nature of asset or liability involved (if any).
 - iii. Either of the following:

- 01. The expected currency amount for hedges of foreign currency exchange risk; that is, specification of the exact amount of foreign currency being hedged
- 02. The quantity of the forecasted transaction for hedges of other risks; that is, specification of the physical quantity (that is, the number of items or units of measure) encompassed by the hedged forecasted transaction.
- iv. If a forecasted sale or purchase is being hedged for price risk, the hedged transaction shall not be specified in either of the following ways:
 - 01. Solely in terms of expected currency amounts
 - 02. As a percentage of sales or purchases during a period.
- v. The current price of a forecasted transaction shall be identified to satisfy the criterion in paragraph 815-20-25-75(b) for offsetting cash flows.
- vi. The hedged forecasted transaction shall be described with sufficient specificity so that when a transaction occurs, it is clear whether that transaction is or is not the hedged transaction. Thus, a forecasted transaction could be identified as the sale of either the first 15,000 units of a specific product sold during a specified 3-month period or the first 5,000 units of a specific product sold in each of 3 specific months, but it could not be identified as the sale of the last 15,000 units of that product sold during a 3-month period (because the last 15,000 units cannot be identified when they occur, but only when the period has ended).
- vii. If the hedged risk is the variability in cash flows attributable to changes in a contractually specified component in a forecasted purchase or sale of a nonfinancial asset, identification of the contractually specified component.
- viii. If the hedged risk is the variability in cash flows attributable to changes in a contractually specified interest rate for forecasted interest receipts or payments on a variable-rate financial asset or liability, identification of the contractually specified interest rate.

815-20-25-3A See paragraphs 815-20-25-133 through 25-142 for guidance on the timing of completing the hedge documentation required by paragraph 815-20-25-3 for a private company that is not a financial institution. The guidance in paragraphs 815-20-25-133 through 25-138 applies to hedging relationships in which the simplified hedge accounting approach is applied. The guidance in paragraphs 815-20-25-139 through 25-142 applies to all hedging relationships other than those in which the simplified hedge accounting approach is applied. The guidance in paragraphs 815-20-25-139 through 25-142 also applies to not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit

bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) in accordance with paragraph 815-20-25-143.

> Eligibility of Hedged Items and Transactions

815-20-25-4 The eligibility criteria for hedged items and transactions are organized as follows:

- a. Hedged item and transaction criteria applicable to both fair value hedges and cash flow hedges
- b. Hedged item criteria applicable to fair value hedges only
- c. Hedged transaction criteria applicable to cash flow hedges only
- d. Hedged items involving **foreign exchange risk**
- e. Items specifically ineligible for designation as a hedged item or transaction.

> > Hedged Item and Transaction Criteria Applicable to both Fair Value Hedges and Cash Flow Hedges

815-20-25-5 Incremental eligibility criteria applicable to both fair value hedges and cash flow hedges are organized as follows:

- a. Hedged items involving **interest rate risk**
- b. Normal purchase or normal sale contract as a hedged item or transaction
- c. Different proportions of the same asset as a hedged item.

> > > Hedged Items Involving Interest Rate Risk

815-20-25-6 Hedges involving a the benchmark interest rate are addressed in ~~paragraph~~ paragraphs 815-20-25-12(f) and 815-20-25-12A (for fair value hedges) and paragraph 815-20-25-15(j) (for cash flow hedges). Hedges involving a contractually specified interest rate are addressed in paragraph 815-20-25-15(j) (for cash flow hedges). The benchmark interest rate or the contractually specified interest rate being hedged in a hedge of **interest rate risk** shall be specifically identified as part of the designation and documentation at the inception of the hedging relationship. Paragraphs 815-20-25-19A through 25-19B provide guidance on the interest rate risk designation of hedges of forecasted issuances or purchases of debt instruments. An entity shall not simply designate prepayment risk as the risk being hedged for a financial asset. However, it can designate the option component of a **prepayable** instrument as the hedged item in a fair value hedge of the entity's exposure to changes in the overall fair value of that prepayment option, perhaps thereby achieving the objective of its desire to hedge prepayment risk. The effect of an **embedded derivative** of the same risk class shall be considered in designating a hedge of an individual risk. For example, the

effect of an embedded prepayment option shall be considered in designating a hedge of interest rate risk.

> > > Benchmark Interest Rate

815-20-25-6A In the United States, ~~currently only the interest rates on direct Treasury obligations of the U.S. government and, for practical reasons, the London Interbank Offered Rate (LIBOR) swap rate and rate, the Fed Funds Effective Swap Rate (also referred to as the Overnight Index Swap Rate) Rate), and the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate~~ are considered to be benchmark interest rates. In each financial market, generally only the ~~one or two~~ most widely used and quoted rates that meet these criteria may be considered benchmark interest rates. ~~The Prime rate, the Federal National Mortgage Association (FNMA or Fannie Mae) Par Mortgage rate, and the Securities Industry and Financial Markets Association Municipal Swap Index (formerly called the Bond Market Association index) shall not be used as the benchmark interest rate in the United States.~~

> > > Fair Value Hedges of Interest Rate Risk in Which the Hedged Item Can Be Settled before Its Scheduled Maturity

815-20-25-6B An entity may designate a fair value hedge of interest rate risk in which the hedged item is a prepayable instrument in accordance with paragraph 815-20-25-6. The entity may consider only how changes in the benchmark interest rate affect the decision to settle the hedged item before its scheduled maturity (for example, an entity may consider only how changes in the benchmark interest rate affect an obligor's decision to call a debt instrument when it has the right to do so). The entity need not consider other factors that would affect this decision (for example, credit risk) when assessing hedge effectiveness. Paragraph 815-25-35-13A discusses the measurement of the hedged item.

> > > Normal Purchases or Normal Sales as Hedged Items or Transactions

815-20-25-7 A contract that is not subject to the requirements of Subtopic 815-10 because it qualifies for the normal purchases and normal sales scope exception may be designated as a hedged item in a fair value hedge, if the provisions of this Section are met. As the hedged item, the contract would be accounted for under fair value hedge accounting. Similarly, the purchase under that contract may be the hedged transaction in a cash flow hedge, if the provisions of paragraph 815-20-25-15 are met. For cash flow hedges, the special accounting applies to the hedging instrument, not to the purchase contract that is related to the hedged forecasted transaction.

815-20-25-8 In emphasizing the conditions in the definition of a **derivative instrument** in paragraphs 815-10-15-83 through 15-139, paragraphs 815-10-15-13 through 15-82 essentially exempt contracts that meet the definition of a derivative instrument from the requirements of Subtopic 815-10 applicable to derivative instruments. However, paragraphs 815-10-15-13 through 15-82 are not intended to preclude such contracts from being subject to the requirements of Subtopic 815-10 applicable to the hedged item in a fair value hedge.

815-20-25-9 A contract that qualifies for the normal purchases and normal sales exception will typically satisfy the criteria for a firm commitment and will not be recognized on an entity's financial statements because of the exclusion from recognition under Subtopic 815-10 or other Topics. The transaction under a contract that qualifies for the normal purchases and normal sales exception but does not satisfy the criteria for a firm commitment because the contract does not contain a fixed price may be the hedged transaction in a cash flow hedge.

> > Different Proportions of the Same Asset as a Hedged Item

815-20-25-10 In a hedging relationship in which a collar that is comprised of a purchased option and a written option that have different **notional amounts** is designated as the hedging instrument and the hedge's effectiveness is assessed based on changes in the collar's intrinsic value, the hedged item may be specified as two different proportions of the same asset referenced in the collar, based on the upper and lower price ranges specified in the two options that make up the collar. That is, the quantities of the asset designated as being hedged may be different based on those price ranges in which the collar's intrinsic value is other than zero. This guidance shall be applied only to collars that are a combination of a single written option and a single purchased option for which the **underlying** in both options is the same. This guidance shall not be applied by analogy to other derivative instruments designated as hedging instruments. Although the quantities of the asset designated as being hedged may be different based on the upper and lower price ranges in the collar, the actual assets that are the subject of the hedging relationship may not change. The quantities that are designated as hedged for a specific price or rate change shall be specified at the inception of the hedging relationship and shall not be changed unless the hedging relationship is dedesignated and a new hedging relationship is redesignated. Since the hedge's effectiveness is based on changes in the collar's intrinsic value, the assessment of hedge effectiveness shall compare the actual change in intrinsic value of the collar to the change in value of the prespecified quantity of the hedged asset that occurred during the hedge period.

> > Hedged Item Criteria Applicable to Fair Value Hedges Only

815-20-25-11 An entity may designate a derivative instrument as hedging the exposure to changes in the fair value of an asset or a liability or an identified portion thereof (hedged item) that is attributable to a particular risk if all applicable criteria in this Section are met.

815-20-25-12 An asset or a liability is eligible for designation as a hedged item in a fair value hedge if all of the following additional criteria are met:

- a. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment.
- b. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof), in which circumstance:
 1. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities shall share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio shall be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk. See the discussion beginning in paragraph 815-20-55-14 for related implementation guidance. An entity may use different stratification criteria for the purposes of ~~Topic 860~~ impairment testing and for the purposes of grouping similar assets to be designated as a hedged portfolio in a fair value hedge.
 2. If the hedged item is a specific portion of an asset or liability (or of a portfolio of similar assets or a portfolio of similar liabilities), the hedged item is one of the following:
 - i. A percentage of the entire asset or liability (or of the entire portfolio). An entity shall not express the hedged item as multiple percentages of a recognized asset or liability and then retroactively determine the hedged item based on an independent matrix of those multiple percentages and the actual scenario that occurred during the period for which hedge effectiveness is being assessed.
 - ii. One or more selected contractual cash flows, including one or more individual interest payments during a selected portion of the term of a debt instrument (such as the portion of the asset or liability representing the present value of the interest payments in any consecutive the first two years of a four-year debt instrument). Paragraph 815-25-35-13B discusses the measurement of the hedged item in hedges of **interest rate risk**.

- iii. A put option or call option (including an interest rate cap or price cap or an interest rate floor or price floor) embedded in an existing asset or liability that is not an embedded derivative accounted for separately pursuant to paragraph 815-15-25-1.
 - iv. The residual value in a lessor's net investment in a direct financing or sales-type lease.
- c. The hedged item presents an exposure to changes in fair value attributable to the hedged risk that could affect reported earnings. The reference to affecting reported earnings does not apply to an entity that does not report earnings as a separate caption in a statement of financial performance, such as a not-for-profit entity (NFP), as discussed in paragraphs 815-30-15-2 through 15-3.
- d. If the hedged item is all or a portion of a debt security (or a portfolio of similar debt securities) that is classified as held to maturity in accordance with Topic 320, the designated risk being hedged is the risk of changes in its fair value attributable to **credit risk**, **foreign exchange risk**, or both. If the hedged item is an option component of a held-to-maturity security that permits its prepayment, the designated risk being hedged is the risk of changes in the entire fair value of that option component. If the hedged item is other than an option component of a held-to-maturity security that permits its prepayment, the designated hedged risk also shall not be the risk of changes in its overall fair value.
- e. If the hedged item is a nonfinancial asset or liability (other than a recognized loan servicing right or a nonfinancial firm commitment with financial components), the designated risk being hedged is the risk of changes in the fair value of the entire hedged asset or liability (reflecting its actual location if a physical asset). That is, the price risk of a similar asset in a different location or of a major ingredient shall not be the hedged risk. Thus, in hedging the exposure to changes in the fair value of gasoline, an entity may not designate the risk of changes in the price of crude oil as the risk being hedged for purposes of determining effectiveness of the fair value hedge of gasoline.
- f. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a nonfinancial firm commitment with financial components, the designated risk being hedged is any of the following:
 - 1. The risk of changes in the overall fair value of the entire hedged item
 - 2. The risk of changes in its fair value attributable to changes in the designated benchmark interest rate (referred to as interest rate risk)
 - 3. The risk of changes in its fair value attributable to changes in the related foreign currency exchange rates (referred to as foreign exchange risk)
 - 4. The risk of changes in its fair value attributable to both of the following (referred to as credit risk):
 - i. Changes in the obligor's creditworthiness

- ii. Changes in the spread over the benchmark interest rate with respect to the hedged item's credit sector at inception of the hedge.
- 5. If the risk designated as being hedged is not the risk in paragraph 815-20-25-12(f)(1), two or more of the other risks (interest rate risk, foreign currency exchange risk, and credit risk) may simultaneously be designated as being hedged.
- g. The item is not otherwise specifically ineligible for designation (see paragraph 815-20-25-43).

815-20-25-12A For a closed portfolio of **prepayable** financial assets or one or more beneficial interests secured by a portfolio of prepayable financial instruments, an entity may designate as the hedged item a stated amount of the asset or assets that are not expected to be affected by prepayments, defaults, and other factors affecting the timing and amount of cash flows if the designation is made in conjunction with the partial-term hedging election in paragraph 815-20-25-12(b)(2)(ii) (this designation is referred to throughout Topic 815 as the "last-of-layer method").

- a. As part of the initial hedge documentation, an analysis shall be completed and documented to support the entity's expectation that the hedged item (that is, the designated last of layer) is anticipated to be outstanding as of the hedged item's assumed maturity date in accordance with the entity's partial-term hedge election. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows associated with the closed portfolio of prepayable financial assets or beneficial interest(s) secured by a portfolio of prepayable financial instruments.
- b. For purposes of its analysis, the entity may assume that as prepayments, defaults, and other events affecting the timing and amount of cash flows occur, they first will be applied to the portion of the closed portfolio of prepayable financial assets or one or more beneficial interests that is not part of the hedged item (that is, the designated last of layer).

> > Hedged Transaction Criteria Applicable to Cash Flow Hedges Only

815-20-25-13 An entity may designate a derivative instrument as hedging the exposure to variability in expected future cash flows that is attributable to a particular risk. That exposure may be associated with either of the following:

- a. An existing recognized asset or liability (such as all or certain future interest payments on variable-rate debt)
- b. A forecasted transaction (such as a forecasted purchase or sale).

Note that the glossary definition of **transaction** is intended to clearly distinguish a transaction from an internal cost allocation or an event that happens within an entity.

815-20-25-14 For purposes of this Subtopic and Subtopic 815-30, the individual cash flows related to a recognized asset or liability and the cash flows related to a forecasted transaction are both referred to as a forecasted transaction or hedged transaction.

815-20-25-15 A forecasted transaction is eligible for designation as a hedged transaction in a cash flow hedge if all of the following additional criteria are met:

- a. The forecasted transaction is specifically identified as either of the following:
 1. A single transaction
 2. A group of individual transactions that share the same risk exposure for which they are designated as being hedged. A forecasted purchase and a forecasted sale shall not both be included in the same group of individual transactions that constitute the hedged transaction.
- b. The occurrence of the forecasted transaction is **probable**.
- c. The forecasted transaction meets both of the following conditions:
 1. It is a transaction with a party external to the reporting entity (except as permitted by paragraphs 815-20-25-30 and 815-20-25-38 through 25-40).
 2. It presents an exposure to variations in cash flows for the hedged risk that could affect reported earnings.
- d. The forecasted transaction is not the acquisition of an asset or incurrence of a liability that will subsequently be remeasured with changes in fair value attributable to the hedged risk reported currently in earnings.
- e. If the forecasted transaction relates to a recognized asset or liability, the asset or liability is not remeasured with changes in fair value attributable to the hedged risk reported currently in earnings.
- f. If the variable cash flows of the forecasted transaction relate to a debt security that is classified as held to maturity under Topic 320, the risk being hedged is the risk of changes in its cash flows attributable to any of the following risks:
 1. Credit risk
 2. Foreign exchange risk.
- g. The forecasted transaction does not involve a business combination subject to the provisions of Topic 805 or a combination accounted for by an NFP that is subject to the provisions of Subtopic 958-805.
- h. The forecasted transaction is not a transaction (such as a forecasted purchase, sale, or dividend) involving either of the following:
 1. A parent entity's interests in consolidated subsidiaries
 2. An entity's own equity instruments.

- i. If the hedged transaction is the forecasted purchase or sale of a nonfinancial asset, the designated risk being hedged is any ~~either~~ of the following:
 1. The risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates
 2. The risk of changes in the cash flows relating to all changes in the purchase price or sales price of the asset reflecting its actual location if a physical asset (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), not the risk of changes in the cash flows relating to the purchase or sale of a similar asset in a different location ~~or of a major ingredient. Thus, for example, in hedging the exposure to changes in the cash flows relating to the purchase of its bronze bar inventory, an entity may not designate the risk of changes in the cash flows relating to purchasing the copper component in bronze as the risk being hedged for purposes of assessing offset as required by paragraph 815-20-25-75(b).~~
 3. The risk of variability in cash flows attributable to changes in a contractually specified component. (See additional criteria in paragraphs 815-20-25-22A through 25-22B for designating the variability in cash flows attributable to changes in a contractually specified component as the hedged risk.)
- j. If the hedged transaction is the forecasted purchase or sale of a financial asset or liability (or the interest payments on that financial asset or liability) or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is any of the following:
 1. The risk of overall changes in the hedged cash flows related to the asset or liability, such as those relating to all changes in the purchase price or sales price (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency)
 2. The For forecasted interest receipts or payments on an existing variable-rate financial instrument, the risk of changes in its cash flows attributable to changes in the designated benchmark interest rate contractually specified interest rate (referred to as interest rate risk). For a forecasted issuance or purchase of a debt instrument (or the forecasted interest payments on a debt instrument), the risk of changes in cash flows attributable to changes in the benchmark interest rate or the expected contractually specified interest rate. See paragraphs 815-20-25-19A through 25-19B for further guidance on the designation of interest rate risk in the forecasted issuance or purchase of a debt instrument.
 3. The risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates (referred to as foreign exchange risk)

4. The risk of changes in its cash flows attributable to all of the following (referred to as credit risk):
 - i. Default
 - ii. Changes in the obligor's creditworthiness
 - iii. Changes in the spread over the contractually specified interest rate or benchmark interest rate with respect to the related financial asset's or liability's credit sector at inception of the hedge.

If the risk designated as being hedged is not the risk in paragraph 815-20-25-15(j)(1), two or more of the other risks (interest rate risk, foreign exchange risk, and credit risk) simultaneously may be designated as being hedged.

- k. The item is not otherwise specifically ineligible for designation (see paragraph 815-20-25-43).

815-20-25-15A This Topic places no limitations on an entity's ability to prospectively designate, dedesignate, and redesignate a qualifying hedge of the same forecasted transaction.

> > > Timing and Probability of the Hedged Forecasted Transaction

815-20-25-16 Example 4 (see paragraph 815-20-55-88) illustrates that how the hedged forecasted transaction is designated and documented in a cash flow hedge is critically important in determining whether it is probable that the hedged forecasted transaction will occur. The following guidance expands on the timing and probability criteria in paragraphs 815-20-25-3 and 815-20-25-15(b) ~~(b) in the preceding paragraph:~~

- a. Effect of counterparty creditworthiness on probability. An entity using a cash flow hedge shall assess the creditworthiness of the counterparty to the hedged forecasted transaction in determining whether the forecasted transaction is probable, particularly if the hedged transaction involves payments pursuant to a contractual obligation of the counterparty.
- b. Probability of forecasted acquisition of a marketable debt security. To qualify for cash flow hedge accounting for an option designated as a hedge of the forecasted acquisition of a marketable debt security, an entity must be able to establish at the inception of the hedging relationship that the acquisition of the marketable debt security is probable, without regard to the means of acquiring it. In documenting the hedging relationship, the entity shall specify the date on or period within which the forecasted acquisition of the security will occur. The evaluation of whether the forecasted acquisition of a marketable debt security is probable of occurring shall be independent of the terms and nature of the derivative instrument designated as the hedging instrument. Specifically, in determining whether an option designated as a hedge of the forecasted

acquisition of a marketable debt security may qualify for cash flow hedge accounting, the probability of the forecasted transaction being consummated shall be evaluated without consideration of whether the option designated as the hedging instrument has an intrinsic value other than zero.

- c. Uncertainty of timing within a range. For forecasted transactions whose timing involves some uncertainty within a range, that range could be documented as the originally specified time period if the hedged forecasted transaction is described with sufficient specificity so that when a transaction occurs, it is clear whether that transaction is or is not the hedged transaction. As long as it remains probable that a forecasted transaction will occur by the end of the originally specified time period, cash flow hedge accounting for that hedging relationship would continue. See paragraph 815-30-40-4 for related guidance and Example 5 (see paragraph 815-20-55-100), which illustrates the application of this paragraph.
- d. Importance of timing in both documentation and hedge effectiveness. Although documenting only the period within which the forecasted transaction will occur is sufficient to comply with the requirements of paragraph 815-20-25-3, compliance with Section 815-20-35 and paragraph 815-20-25-75(b) requires that the best estimate of the forecasted transaction's timing be both documented and used in assessing hedge effectiveness. As explained in paragraphs 815-20-25-84 and 815-20-25-120 through 25-121, the time value of money is likely to be important in the assessment of cash flow hedge effectiveness, especially if the entity plans to use a rollover or tailing strategy to hedge its forecasted transaction. The use of time value of money requires information about the timing of cash flows.
- e. The term *probable* requires a significantly greater likelihood of occurrence than the phrase *more likely than not*.
- f. The cash flow hedging model does not require that it be probable that any variability in the hedged transaction will actually occur—that is, in a cash flow hedge, the variability in future cash flows must be a possibility, but not necessarily a probability. However, the hedging derivative must be highly effective at achieving offsetting cash flows whenever that variability in future interest does occur.

> > > Forecasted Issuances or Purchases of Fixed-Rate Debt Instruments as a Hedged Transaction

~~815-20-25-17 Paragraph 815-20-25-43 explains that the restriction against hedging interest rate risk in paragraph 815-20-25-43(d)(3) does not apply to a cash flow hedge of the forecasted issuance or forecasted purchase of fixed rate debt because the contractually fixed interest rate established at the issuance of fixed-rate debt is based on current market interest rates for that debtor and the debt's~~

~~future interest payments will not be variable explicitly based on any index.~~ In this Subtopic, the phrase *issuance of fixed-rate debt* includes the issuance of a zero-coupon instrument because the interest element in a zero-coupon instrument is fixed at its issuance.

815-20-25-18 Provided the entity meets all the other cash flow hedging criteria, an entity may designate as the hedged risk the risk of changes in either of the following:

- a. The coupon payments (or the interest element of the final cash flow if interest is paid only at maturity) related to the forecasted issuance of fixed-rate debt
- b. The total proceeds attributable to changes in the benchmark interest rate related to the forecasted issuance of fixed-rate debt.

The derivative instrument used to hedge either of these risks must provide offsetting cash flows for the hedging relationship to be effective in accordance with paragraph 815-20-35-3.

815-20-25-19 An entity shall not characterize its variable-rate debt as fixed-rate debt that, at each interest reset date, is effectively rolled over to another issuance of fixed-rate debt that has a new fixed interest rate until the next reset date. ~~Such a characterization cannot justify not applying the restriction against hedging interest rate risk in paragraph 815-20-25-43(d)(3) to variable rate debt.~~

815-20-25-19A In accordance with paragraph 815-20-25-6, if an entity designates a cash flow hedge of interest rate risk attributable to the variability in cash flows of a forecasted issuance or purchase of a debt instrument, it shall specify the nature of the interest rate risk being hedged as follows:

- a. If an entity expects that it will issue or purchase a fixed-rate debt instrument, the entity shall designate the variability in cash flows attributable to changes in the benchmark interest rate as the hedged risk.
- b. If an entity expects that it will issue or purchase a variable-rate debt instrument, the entity shall designate the variability in cash flows attributable to changes in the contractually specified interest rate as the hedged risk.

815-20-25-19B If an entity does not know at the inception of the hedging relationship whether the debt instrument that will be issued or purchased will be fixed rate or variable rate, the entity shall designate as the hedged risk the variability in cash flows attributable to changes in a rate that would qualify both as a benchmark interest rate if the instrument issued or purchased is fixed rate and as a contractually specified interest rate if the instrument issued or purchased is variable rate.

> > > Interest Rate Risk of Prepayable Obligations

815-20-25-20 Paragraph 815-20-25-15(a) does not require that hedged variable interest payments relate to a specific unchanging obligation or group of variable-rate obligations if those obligations are prepayable. Example 7 (see paragraph 815-20-55-106) illustrates this principle.

> > > All-in-One Hedge

815-20-25-21 Paragraph 815-10-15-4 states that, if a contract meets the definition of both a derivative instrument and a firm commitment under the Derivatives and Hedging Topic (as illustrated in Example 8 [see paragraph 815-20-55-111]), then an entity shall account for the contract as a derivative instrument unless one of the exceptions in this Topic applies. In that circumstance, either of the following may be true:

- a. The forecasted transaction and the derivative instrument used to hedge it are with the same counterparty.
- b. The derivative instrument is the same contract under which the entity executes the forecasted transaction.

815-20-25-22 Assuming other cash flow hedge criteria are met, a derivative instrument that will involve gross settlement may be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in a forecasted transaction that will occur upon gross settlement of the derivative instrument itself (an **all-in-one hedge**). This guidance applies to fixed-price contracts to acquire or sell a nonfinancial or financial asset that are accounted for as derivative instruments under this Topic provided the criteria for a cash flow hedge are met.

> > > Eligibility Criteria for Designating the Variability in Cash Flows Attributable to Changes in a Contractually Specified Component for the Purchase or Sale of a Nonfinancial Asset as the Hedged Risk

815-20-25-22A For existing contracts, determining whether the variability in cash flows attributable to changes in a **contractually specified component** may be designated as the hedged risk in a cash flow hedge is based on the following:

- a. If the contract to purchase or sell a nonfinancial asset is a derivative in its entirety and an entity applies the normal purchases and normal sales scope exception in accordance with Subtopic 815-10, any contractually specified component in the contract is eligible to be designated as the hedged risk. If the entity does not apply the normal purchases and normal sales scope exception, no pricing component is eligible to be designated as the hedged risk.

- b. If the contract to purchase or sell a nonfinancial asset is not a derivative in its entirety, any contractually specified component remaining in the host contract (that is, the contract to purchase or sell a nonfinancial asset after any embedded derivatives have been bifurcated in accordance with Subtopic 815-15) is eligible to be designated as the hedged risk.

815-20-25-22B An entity may designate the variability in cash flows attributable to changes in a contractually specified component in accordance with paragraph 815-20-25-15(i)(3) to purchase or sell a nonfinancial asset for a period longer than the contractual term or for a not-yet-existing contract to purchase or sell a nonfinancial asset if the entity expects that the requirements in paragraph 815-20-25-22A will be met when the contract is executed. Once the contract is executed, the entity shall apply the guidance in paragraph 815-20-25-22A to determine whether the variability in cash flows attributable to changes in the contractually specified component can continue to be designated as the hedged risk. See paragraphs 815-20-55-26A through 55-26E for related implementation guidance.

> > Hedged Items and Transactions Involving Foreign Exchange Risk

815-20-25-23 Under the functional currency concept of Topic 830, exposure to a foreign currency exists only in relation to a specific operating unit's designated functional currency cash flows. Therefore, exposure to foreign currency risk shall be assessed at the unit level.

815-20-25-24 A unit has exposure to foreign currency risk only if it enters into a transaction (or has an exposure) denominated in a currency other than the unit's functional currency.

815-20-25-25 Due to the requirement in Topic 830 for remeasurement of assets and liabilities denominated in a foreign currency into the unit's functional currency, changes in exchange rates for those currencies will give rise to exchange gains or losses, which results in direct foreign currency exposure for the unit but not for the parent entity if its functional currency differs from its unit's functional currency.

815-20-25-26 The functional currency concepts of Topic 830 are relevant if the foreign currency exposure being hedged relates to any of the following:

- a. An unrecognized foreign-currency-denominated firm commitment
- b. A recognized foreign-currency-denominated asset or liability
- c. A foreign-currency-denominated forecasted transaction
- d. The forecasted functional-currency-equivalent cash flows associated with a recognized asset or liability
- e. A net investment in a foreign operation.

815-20-25-27 Because a parent entity whose functional currency differs from its subsidiary's functional currency is not directly exposed to the risk of exchange rate changes due to a subsidiary transaction that is denominated in a currency other than a subsidiary's functional currency, the parent cannot qualify for hedge accounting for a hedge of that risk. Accordingly, a parent entity that has a different functional currency cannot qualify for hedge accounting for direct hedges of a subsidiary's recognized asset or liability, unrecognized firm commitment or forecasted transaction denominated in a currency other than the subsidiary's functional currency. Also, a parent that has a different functional currency cannot qualify for hedge accounting for a hedge of a net investment of a first-tier subsidiary in a second-tier subsidiary.

815-20-25-28 If the hedged item is denominated in a foreign currency, an entity may designate any of the following types of hedges of foreign currency exposure:

- a. A fair value hedge of an unrecognized firm commitment or a recognized asset or liability (including an available-for-sale debt security)
- b. A cash flow hedge of any of the following:
 - 1. A forecasted transaction
 - 2. An unrecognized firm commitment
 - 3. The forecasted functional-currency-equivalent cash flows associated with a recognized asset or liability
 - 4. A forecasted intra-entity transaction.
- c. A hedge of a net investment in a foreign operation.

815-20-25-29 The recognition in earnings of the foreign currency transaction gain or loss on a foreign-currency-denominated asset or liability based on changes in the foreign currency **spot rate** is not considered to be the remeasurement of that asset or liability with changes in fair value attributable to foreign exchange risk recognized in earnings, which is discussed in the criteria in paragraphs 815-20-25-15(d) and 815-20-25-43(c). Thus, those criteria are not impediments to either of the following:

- a. A foreign currency fair value or cash flow hedge of such a foreign-currency-denominated asset or liability
- b. A foreign currency cash flow hedge of the forecasted acquisition or incurrence of a foreign-currency-denominated asset or liability whose carrying amount will be remeasured at spot exchange rates under paragraph 830-20-35-1.

815-20-25-30 Both of the following conditions shall be met for foreign currency cash flow hedges, foreign currency fair value hedges, and hedges of the net investment in a foreign operation:

- a. For consolidated financial statements, either of the following conditions is met:

1. The operating unit that has the foreign currency exposure is a party to the hedging instrument.
 2. Another member of the consolidated group that has the same functional currency as that operating unit is a party to the hedging instrument and there is no intervening subsidiary with a different functional currency. See guidance beginning in paragraph 815-20-25-52 for conditions under which an intra-entity foreign currency derivative can be the hedging instrument in a cash flow hedge of foreign exchange risk.
- b. The hedged transaction is denominated in a currency other than the hedging unit's functional currency.

815-20-25-31 However, a subsidiary may enter into an intra-entity hedging instrument with the parent entity, and that contract can be a hedging instrument in the consolidated financial statements if the parent entity enters into an offsetting contract (pursuant to paragraph 815-20-25-52 for the appropriate hedging relationship) with an unrelated third party to hedge the exposure it acquired from issuing the derivative instrument to the subsidiary that initiated the hedge.

815-20-25-32 If a subsidiary has the same functional currency as the parent entity or other member of the consolidated group, the parent entity or that other member of the consolidated group may, subject to certain restrictions, enter into a derivative instrument or nonderivative instrument that is designated as the hedging instrument in a hedge of that subsidiary's foreign exchange risk in consolidated financial statements.

815-20-25-33 In some instances, it may not be practical or feasible to hedge in the same currency and, therefore, a hedging instrument also may be denominated in a currency for which the exchange rate generally moves in tandem with the exchange rate for the currency in which the hedged item is denominated.

> > > Sale or Purchase on Credit as a Hedged Item Involving Foreign Exchange Risk

815-20-25-34 The provisions of this Section (including paragraph 815-20-25-28) that permit a recognized foreign-currency-denominated asset or liability to be the hedged item in a fair value or cash flow hedge of foreign currency exposure also pertain to a recognized foreign-currency-denominated receivable or payable that results from a hedged forecasted foreign-currency-denominated sale or purchase on credit. Specifically, an entity may choose to designate either of the following:

- a. A single cash flow hedge that encompasses the variability of functional currency cash flows attributable to foreign exchange risk related to the settlement of the foreign-currency-denominated receivable or payable resulting from a forecasted sale or purchase on credit

- b. Both of the following separate hedges:
 - 1. A cash flow hedge of the variability of functional currency cash flows attributable to foreign exchange risk related to a forecasted foreign-currency-denominated sale or purchase on credit
 - 2. A foreign currency fair value hedge of the resulting recognized foreign-currency-denominated receivable or payable.

815-20-25-35 If two separate hedges are designated, the cash flow hedge would terminate (that is, be dedesignated) when the hedged sale or purchase occurs and the foreign-currency-denominated receivable or payable is recognized.

815-20-25-36 The use of the same foreign currency derivative instrument for both the cash flow hedge and the fair value hedge is not prohibited ~~though some ineffectiveness may result.~~

> > > Items in Fair Value Hedges of Foreign Exchange Risk

815-20-25-37 This paragraph identifies possible hedged items in fair value hedges of foreign exchange risk. If every applicable criterion is met, all of the following are eligible for designation as a hedged item in a fair value hedge of foreign exchange risk:

- a. Recognized asset or liability. A derivative instrument can be designated as hedging the changes in the fair value of a recognized asset or liability (or a specific portion thereof) for which a foreign currency transaction gain or loss is recognized in earnings under the provisions of paragraph 830-20-35-1. All recognized foreign-currency-denominated assets or liabilities for which a foreign currency transaction gain or loss is recorded in earnings shall qualify for the accounting specified in Subtopic 815-25 if all the fair value hedge criteria in this Section (including the conditions in paragraph 815-20-25-30(a) through (b)) are met.
- b. Available-for-sale debt security. A derivative instrument can be designated as hedging the changes in the fair value of an available-for-sale debt security (or a specific portion thereof) attributable to changes in foreign currency exchange rates. The designated hedging relationship qualifies for the accounting specified in Subtopic 815-25 if all the fair value hedge criteria in this Section (including the conditions in paragraph 815-20-25-30(a) through (b)) are met.
- c. Subparagraph superseded by Accounting Standards Update No. 2016-01.
- d. Unrecognized firm commitment. Paragraph 815-20-25-58 states that a derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss under Topic 830 can be designated as hedging changes in the fair value of an unrecognized firm

commitment, or a specific portion thereof, attributable to foreign currency exchange rates.

> > > Items and Transactions in Cash Flow Hedges of Foreign Exchange Risk

815-20-25-38 The conditions in the following paragraph relate to a derivative instrument designated as hedging the foreign currency exposure to variability in the functional-currency-equivalent cash flows associated with any of the following:

- a. A forecasted transaction (for example, a forecasted export sale to an unaffiliated entity with the price to be denominated in a foreign currency)
- b. A recognized asset or liability
- c. An unrecognized firm commitment
- d. A forecasted intra-entity transaction (for example, a forecasted sale to a foreign subsidiary or a forecasted royalty from a foreign subsidiary).

815-20-25-39 A hedging relationship of the type described in the preceding paragraph qualifies for hedge accounting if all the following criteria are met:

- a. The criteria in paragraph 815-20-25-30(a) through (b) are met.
- b. All of the cash flow hedge criteria in this Section otherwise are met, except for the criterion in paragraph 815-20-25-15(c) that requires that the forecasted transaction be with a party external to the reporting entity.
- c. If the hedged transaction is a group of individual forecasted foreign-currency-denominated transactions, a forecasted inflow of a foreign currency and a forecasted outflow of the foreign currency cannot both be included in the same group.
- d. If the hedged item is a recognized foreign-currency-denominated asset or liability, all the variability in the hedged item's functional-currency-equivalent cash flows shall be eliminated by the effect of the hedge.

815-20-25-40 For purposes of item (d) in the preceding paragraph, an entity shall not specifically exclude a risk from the hedge that will affect the variability in cash flows. For example, a cash flow hedge cannot be used with a variable-rate foreign-currency-denominated asset or liability and a derivative instrument based solely on changes in exchange rates because the derivative instrument does not eliminate all the variability in the functional currency cash flows. As long as no element of risk that affects the variability in foreign-currency-equivalent cash flows has been specifically excluded from a foreign currency cash flow hedge and the hedging instrument is highly effective at providing the necessary offset in the variability of all cash flows, a less-than-perfect hedge would meet the requirement in (d) in the preceding paragraph. That criterion does not require that the derivative instrument used to hedge the foreign currency exposure of the forecasted foreign-currency-equivalent cash flows associated with a recognized asset or liability be

perfectly effective, rather it is intended to ensure that the hedging relationship is highly effective at offsetting all risks that impact the variability of cash flows.

815-20-25-41 If all of the variability of the functional-currency-equivalent cash flows is eliminated as a result of the hedge (as required by paragraph 815-20-25-39(d)), an entity can use cash flow hedge accounting to hedge the variability in the functional-currency-equivalent cash flows associated with any of the following:

- a. All of the payments of both principal and interest of a foreign-currency-denominated asset or liability
- b. All of the payments of principal of a foreign-currency-denominated asset or liability
- c. All or a fixed portion of selected payments of either principal or interest of a foreign-currency-denominated asset or liability
- d. Selected payments of both principal and interest of a foreign-currency-denominated asset or liability (for example, principal and interest payments on December 31, 20X1, and December 31, 20X3).

> > > Foreign Exchange Risk of a Firm Commitment as Hedged Transaction in a Cash Flow Hedge

815-20-25-42 The reference in the definition of a forecasted transaction indicating that a forecasted transaction is not a firm commitment focuses on firm commitments that have no variability. The reference does not preclude a cash flow hedge of the variability in functional-currency-equivalent cash flows if the commitment's fixed price is denominated in a foreign currency. Although that definition of a firm commitment requires a fixed price, it permits the fixed price to be denominated in a foreign currency. A firm commitment can expose the parties to variability in their functional-currency-equivalent cash flows. The definition of a forecasted transaction also indicates that the transaction or event will occur at the prevailing market price. From the perspective of the hedged risk (foreign exchange risk), the translation of the foreign currency proceeds from the sale of the nonfinancial assets will occur at the prevailing market price (that is, current exchange rate). Example 14 (see paragraph 815-20-55-136) illustrates the application of this guidance.

> > Items Specifically Ineligible for Designation as a Hedged Item or Transaction

815-20-25-43 Besides those hedged items and transactions that fail to meet the specified eligibility criteria, none of the following shall be designated as a hedged item or transaction in the respective hedges:

- a. Subparagraph not used
- b. With respect to both fair value hedges and cash flow hedges:

1. An investment accounted for by the equity method in accordance with the requirements of Subtopic 323-10 or in accordance with the requirements of Topic 321
 2. A **noncontrolling interest** in one or more consolidated subsidiaries
 3. Transactions with stockholders as stockholders, such as either of the following:
 - i. Projected purchases of treasury stock
 - ii. Payments of dividends.
 4. Intra-entity transactions (except for foreign-currency-denominated forecasted intra-entity transactions) between entities included in consolidated financial statements
 5. The price of stock expected to be issued pursuant to a stock option plan for which recognized compensation expense is not based on changes in stock prices after the date of grant.
- c. With respect to fair value hedges only:
1. If the entire asset or liability is an instrument with variable cash flows, an implicit fixed-to-variable swap (or similar instrument) perceived to be embedded in a host contract with fixed cash flows
 2. For a held-to-maturity debt security, the risk of changes in its fair value attributable to interest rate risk
 3. An asset or liability that is remeasured with the changes in fair value attributable to the hedged risk reported currently in earnings
 4. An equity investment in a consolidated subsidiary
 5. A firm commitment either to enter into a business combination or to acquire or dispose of a subsidiary, a noncontrolling interest, or an equity method investee
 6. An equity instrument issued by the entity and classified in stockholders' equity in the statement of financial position
 7. A component of an embedded derivative in a hybrid instrument—for example, embedded options in a **hybrid instrument** that are required to be considered a single forward contract under paragraph 815-10-25-10 cannot be designated as items hedged individually in a fair value hedge in which the hedging instrument is a separate, unrelated freestanding option.
- d. With respect to cash flow hedges only:
1. Subparagraph not used
 2. If variable cash flows of the forecasted transaction relate to a debt security that is classified as held-to-maturity under Topic 320, the risk of changes in its cash flows attributable to interest rate risk
 3. Subparagraph superseded by Accounting Standards Update No. 2017-12. ~~In a cash flow hedge of a variable rate financial asset or liability, either existing or forecasted, the risk of changes in its cash flows attributable to changes in the specifically identified benchmark interest rate if the cash flows of the hedged transaction are explicitly based on a different index, for example, based on a specific bank's prime rate, which cannot qualify as the benchmark rate. That is, the~~

~~hedged risk cannot be designated as interest rate risk unless the cash flows of the hedged transaction are explicitly based on that same benchmark interest rate. However, the risk designated as being hedged could potentially be the risk of overall changes in the hedged cash flows related to the asset or liability, if the other criteria for a cash flow hedge have been met.~~

~~The restriction against hedging interest rate risk in item (d)(3) does not apply to a cash flow hedge of the forecasted issuance or forecasted purchase of fixed rate debt.~~

815-20-25-44 The earnings exposure criterion specifically precludes hedge accounting for derivative instruments used to hedge items in (b)(3) through (b)(5) in the preceding paragraph. However, intra-entity transactions may present an earnings exposure for a subsidiary in its freestanding financial statements; a hedge of an intra-entity transaction would be eligible for hedge accounting for purposes of those statements.

> Eligibility of Hedging Instruments

815-20-25-45 Either all or a proportion of a derivative instrument (including a compound embedded derivative that is accounted for separately) may be designated as a hedging instrument. Two or more derivative instruments, or proportions thereof, may also be viewed in combination and jointly designated as the hedging instrument. A proportion of a derivative instrument or derivative instruments designated as the hedging instrument shall be expressed as a percentage of the entire derivative instrument(s) so that the profile of risk exposures in the hedging portion of the derivative instrument(s) is the same as that in the entire derivative instrument(s). Subsequent references in the Derivatives and Hedging Topic to a derivative instrument as a hedging instrument include the use of only a proportion of a derivative instrument as a hedging instrument. Whether a written option may be designated as a hedging instrument depends on the terms of both the hedging instrument and the hedged item as discussed beginning in paragraph 815-20-25-94.

815-20-25-46 The eligibility criteria for hedging instruments are organized as follows:

- a. **Intra-entity derivatives**
- b. Subparagraph not used
- c. Hedging instrument in a cash flow hedge of basis risk
- d. Hedging instruments in hedges of foreign exchange risk
- e. Instruments specifically ineligible for designation as hedging instruments.

> > Intra-entity Derivatives

815-20-25-46A There is no requirement in this Subtopic that the operating unit with the interest rate, market price, or credit risk exposure be a party to the hedging instrument. Thus, for example, a parent entity's central treasury function can enter into a derivative instrument with a third party and designate it as the hedging instrument in a hedge of a subsidiary's interest rate risk for purposes of the consolidated financial statements. However, if the subsidiary wishes to qualify for hedge accounting of the interest rate exposure in its separate-entity financial statements, the subsidiary (as the reporting entity) shall be a party to the hedging instrument, which can be an intra-entity derivative obtained from the central treasury function. Thus, an intra-entity derivative for interest rate risk can qualify for designation as the hedging instrument in separate-entity financial statements but not in consolidated financial statements. (As used in this guidance, the term *subsidiary* refers only to a consolidated subsidiary. This guidance shall not be applied directly or by analogy to an equity method investee.)

815-20-25-46B An intra-entity derivative shall not be designated as the hedging instrument if the hedged risk is any of the following:

- a. The risk of changes in the overall fair value or cash flows of the entire hedged item or transaction
- b. The risk of changes in hedged item's or transaction's fair value attributable to changes in the designated benchmark interest rate or cash flows attributable to changes in the contractually specified interest rate or designated benchmark interest rate
- c. The risk of changes in hedged item's or transaction's fair value or cash flows attributable to changes in credit risk.
- d. The risk of variability in cash flows attributable to changes in a contractually specified component to purchase or sell a nonfinancial asset.

Similarly, a derivative instrument contract between operating units within a single legal entity shall not be designated as the hedging instrument in a hedge of those risks. Only a derivative instrument with an unrelated third party can be designated as the hedging instrument in a hedge of those risks in consolidated financial statements.

815-20-25-47 Paragraph not used.

815-20-25-48 Paragraph not used.

815-20-25-49 Paragraph not used.

> > Hedging Instrument in a Cash Flow Hedge of Basis Risk

815-20-25-50 If a hedging instrument is used to modify the contractually specified interest receipts or payments associated with a recognized financial asset or liability from one variable rate to another variable rate, the hedging instrument shall meet both of the following criteria:

- a. It is a link between both of the following:
 - 1. An existing designated asset (or group of similar assets) with variable cash flows
 - 2. An existing designated liability (or group of similar liabilities) with variable cash flows.
- b. It is highly effective at achieving offsetting cash flows.

815-20-25-51 For purposes of paragraph 815-20-25-50, a link exists if both of the following ~~conditions~~ criteria are met:

- a. The basis (that is, the rate index on which the interest rate is based) of one leg of an interest rate swap is the same as the basis of the contractually specified interest receipts for the designated asset.
- b. The basis of the other leg of the swap is the same as the basis of the contractually specified interest payments for the designated liability.

In this situation, the criterion in paragraph 815-20-25-15(a) is applied separately to the designated asset and the designated liability.

> > Hedging Instruments in Hedges of Foreign Exchange Risk

815-20-25-51A The guidance on hedging instruments in hedges of foreign exchange risk is organized as follows:

- a. Intra-entity derivatives
- b. Hedging instruments in fair value hedges involving foreign exchange risk
- c. Internal derivatives as hedging instruments in cash flow hedges of foreign exchange risk
- d. Hedging instruments in net investment hedges.

> > > Intra-Entity Derivatives

815-20-25-52 A foreign currency derivative instrument that has been entered into with another member of a consolidated group can be a hedging instrument in any of the following hedging relationships only if that other member of the consolidated group has entered into an offsetting contract with an unrelated third party to hedge the exposure it acquired from issuing the derivative instrument to the affiliate that initiated the hedge:

- a. A fair value hedge
- b. A cash flow hedge of a recognized foreign-currency-denominated asset or liability
- c. A net investment hedge in the consolidated financial statements.

815-20-25-53 Paragraph 815-20-25-46A states that there is no requirement in this Subtopic that the operating unit with the interest rate, market price, or credit risk exposure be a party to the hedging instrument and provides related guidance.

815-20-25-54 An intra-entity derivative can be designated as a hedging instrument in consolidated financial statements if all of the following conditions are condition (a) is met and either condition (b) or (c) is met:

- a. The hedged risk is either of the following:
 - 1. The risk of changes in fair value or cash flows attributable to changes in a foreign currency exchange rate
 - 2. The foreign exchange risk for a net investment in a foreign operation.
- b. In a fair value hedge or in a cash flow hedge of a recognized foreign-currency-denominated asset or liability or in a net investment hedge in the consolidated financial statements the counterparty (that is, the other member of the consolidated group) has entered into a contract with an unrelated third party that offsets the intra-entity derivative completely, thereby hedging the exposure it acquired from issuing the intra-entity derivative to the affiliate that designated the hedge.
- c. In a foreign currency cash flow hedge of a forecasted borrowing, purchase, or sale or an unrecognized firm commitment the counterparty has entered into a derivative instrument with an unrelated third party to offset the exposure that results from that **internal derivative** or, if the conditions in paragraphs 815-20-25-62 through 25-63 are met, entered into derivative instruments with unrelated third parties that would offset, on a net basis for each foreign currency, the foreign exchange risk arising from multiple internal derivative instruments.

815-20-25-55 The designation of intra-entity derivatives as hedging instruments for hedges of foreign exchange risk enables entities to continue using a central treasury function for derivative instruments with third parties and still comply with the requirement in paragraph 815-20-25-30(a) that the operating unit with the foreign currency exposure be a party to the hedging instrument.

815-20-25-56 Paragraph 815-20-25-46B states that an intra-entity derivative shall not be designated as the hedging instrument in other circumstances and provides related guidance.

815-20-25-57 Paragraph not used.

> > > Hedging Instruments in Fair Value Hedges Involving Foreign Exchange Risk

815-20-25-58 A derivative instrument or a nonderivative **financial instrument** that may give rise to a foreign currency transaction gain or loss under Topic 830 can be designated as hedging changes in the fair value of an unrecognized firm commitment, or a specific portion thereof, attributable to foreign currency exchange rates. The designated hedging relationship qualifies for the accounting specified in Subtopic 815-25 if all the fair value hedge conditions in this Section and the conditions in paragraph 815-20-25-30 are met.

815-20-25-59 The carrying basis for a nonderivative financial instrument that gives rise to a foreign currency transaction gain or loss under Subtopic 830-20 is not addressed by this Subtopic.

815-20-25-60 An entity may designate an intra-entity loan or other payable as the hedging instrument in a foreign currency fair value hedge of an unrecognized firm commitment and qualify for hedge accounting in the consolidated financial statements. That designation is consistent with the ability under paragraphs 815-20-25-58 through 25-59 to designate nonderivative instruments as hedging instruments in foreign currency fair value hedges of firm commitments. However, hedge accounting in the consolidated financial statements shall only be applied if the member of the consolidated entity that is the counterparty to the intra-entity loan has entered into a third-party contract that offsets the foreign exchange exposure of that entity's intra-entity loan receivable. That is, the requirement in paragraphs 815-20-25-28 through 25-29 that an intra-entity derivative instrument designated as a hedging instrument in a foreign currency fair value hedge be offset by a third-party contract would also apply to intra-entity nonderivative instruments designated as hedging instruments. To remain consistent with the notion that the intra-entity contract is simply a conduit for the third-party exposure, an intra-entity loan designated as a hedging instrument shall be offset by a third-party loan (that is, it shall not be offset by a derivative instrument). Hedge accounting shall be applied in consolidation only to those gains and losses occurring during the period that the offsetting third-party loan is in place.

> > > Internal Derivatives as Hedging Instruments in Cash Flow Hedges of Foreign Exchange Risk

815-20-25-61 An internal derivative can be a hedging instrument in a foreign currency cash flow hedge of a forecasted borrowing, purchase, or sale or an unrecognized firm commitment in the consolidated financial statements only if both of the following conditions are satisfied:

- a. From the perspective of the member of the consolidated group using the derivative instrument as a hedging instrument (the hedging affiliate), the criteria for foreign currency cash flow hedge accounting otherwise specified in this Section are satisfied.
- b. The member of the consolidated group not using the derivative instrument as a hedging instrument (the issuing affiliate) either:
 - 1. Enters into a derivative instrument with an unrelated third party to offset the exposure that results from that internal derivative
 - 2. If the conditions in paragraphs 815-20-25-62 through 25-63 are met, enters into derivative instruments with unrelated third parties that would offset, on a net basis for each foreign currency, the foreign exchange risk arising from multiple internal derivative instruments. In complying with this guidance the issuing affiliate could enter into a third-party position with neither leg of the third-party position being the issuing affiliate's functional currency to offset its exposure if the amount of the respective currencies of each leg are equivalent with respect to each other based on forward exchange rates.

815-20-25-62 If an issuing affiliate chooses to offset exposure arising from multiple internal derivatives on an aggregate or net basis, the derivative instruments issued to hedging affiliates shall qualify as cash flow hedges in the consolidated financial statements only if all of the following conditions are satisfied:

- a. The issuing affiliate enters into a derivative instrument with an unrelated third party to offset, on a net basis for each foreign currency, the foreign exchange risk arising from multiple internal derivatives.
- b. The derivative instrument with the unrelated third party generates equal or closely approximating gains and losses when compared with the aggregate or net losses and gains generated by the derivative instruments issued to affiliates.
- c. Internal derivatives that are not designated as hedging instruments are excluded from the determination of the foreign currency exposure on a net basis that is offset by the third-party derivative instrument. Nonderivative contracts shall not be used as hedging instruments to offset exposures arising from internal derivatives.
- d. Foreign currency exposure that is offset by a single net third-party contract arises from internal derivatives that mature within the same 31-day period and that involve the same currency exposure as the net third-party derivative instrument. The offsetting net third-party derivative instrument related to that group of contracts shall meet all of the following criteria:
 - 1. It offsets the aggregate or net exposure to that currency.
 - 2. It matures within the same 31-day period.
 - 3. It is entered into within three business days after the designation of the internal derivatives as hedging instruments.

- e. The issuing affiliate meets both of the following conditions:
 - 1. It tracks the exposure that it acquires from each hedging affiliate.
 - 2. It maintains documentation supporting linkage of each internal derivative and the offsetting aggregate or net derivative instrument with an unrelated third party.
- f. The issuing affiliate does not alter or terminate the offsetting derivative instrument with an unrelated third party unless the hedging affiliate initiates that action.

815-20-25-63 If the issuing affiliate alters or terminates any offsetting third-party derivative (which should be rare), the hedging affiliate shall prospectively cease hedge accounting for the internal derivatives that are offset by that third-party derivative instrument.

815-20-25-64 A member of a consolidated group cannot meet the offsetting criteria by offsetting exposures arising from multiple internal derivative contracts on a net basis for foreign currency cash flow exposures related to recognized foreign-currency-denominated assets or liabilities. That prohibition includes situations in which a recognized foreign-currency-denominated asset or liability in a fair value hedge or cash flow hedge results from the occurrence of a specifically identified forecasted transaction initially designated as a cash flow hedge.

815-20-25-65 A qualifying foreign currency cash flow hedge shall be accounted for as specified in Subtopic 815-30.

> > Hedging Instruments in Net Investment Hedges

815-20-25-66 A derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss under Subtopic 830-20 can be designated as hedging the foreign currency exposure of a net investment in a foreign operation provided the conditions in paragraph 815-20-25-30 are met. A nonderivative financial instrument that is reported at fair value does not give rise to a foreign currency transaction gain or loss under Subtopic 830-20 and, thus, cannot be designated as hedging the foreign currency exposure of a net investment in a foreign operation.

815-20-25-67 Hedging instruments that are eligible for designation in a net investment hedge include, among others, both of the following:

- a. A receive-variable-rate, pay-variable-rate cross-currency interest rate swap, provided both of the following conditions are met:
 - 1. The interest rates are based on the same currencies contained in the swap.
 - 2. Both legs of the swap have the same repricing intervals and dates.

- b. A receive-fixed-rate, pay-fixed-rate cross-currency interest rate swap. A cross-currency interest rate swap that has two fixed legs is not a compound derivative instrument and, therefore, is not subject to the criteria in (a).

815-20-25-68 A cross-currency interest rate swap that has either two variable legs or two fixed legs has a fair value that is primarily driven by changes in foreign exchange rates rather than changes in interest rates. Therefore, foreign exchange risk, rather than interest rate risk, is the dominant risk exposure in such a swap.

815-20-25-68A Under the guidance in paragraph 815-20-25-71(d)(1), a cross-currency interest rate swap with one fixed-rate leg and one floating-rate leg cannot be designated as the hedging instrument in a net investment hedge.

815-20-25-69 To designate a derivative instrument as a hedge of a net investment, an entity shall have an expectation that the derivative instrument will be effective as an economic hedge of foreign exchange risk associated with the hedged net investment. Accordingly, if any difference in **notional amount**, currencies, or underlyings is present, the entity shall establish an expectation that the actual derivative instrument designated as the hedging instrument will be effective as an economic hedge.

815-20-25-70 For example, if an entity designates a derivative instrument that has an underlying exchange rate involving a currency other than the functional currency of the net investment, that exchange rate shall be expected to move in tandem with the exchange rate between the functional currency of the hedged net investment and the investor's functional currency. Use of a currency different from the exposed currency is not limited to cases in which it is not practical or feasible to hedge in the exposed currency if all other qualifying criteria are met.

> > Instruments Specifically Ineligible for Designation as Hedging Instruments

815-20-25-71 Besides those hedging instruments that fail to meet the specified eligibility criteria, none of the following shall be designated as a hedging instrument for the respective hedges:

- a. With respect to fair value hedges, cash flow hedges, and net investment hedges:
 - 1. A nonderivative instrument, such as a U.S. Treasury note, except as provided in paragraphs 815-20-25-58 through 25-59 and 815-20-25-66
 - 2. Components of a compound derivative instrument representing different risks
 - 3. A hybrid financial instrument that an entity irrevocably elects under paragraph 815-15-25-4 to initially and subsequently measure in its

- entirety at fair value (with changes in fair value recognized in earnings)
4. A hybrid instrument for which an entity cannot reliably identify and measure the embedded derivative instrument that paragraph 815-15-25-1 requires be separated from the host contract
 5. Any of the individual components of a compound embedded derivative that is separated from the host contract.
- b. With respect to fair value hedges only:
 1. A nonderivative financial instrument as the hedging instrument in a fair value hedge of the foreign currency exposure of a recognized asset or liability.
 2. A nonderivative financial instrument as the hedging instrument in a fair value hedge of the foreign currency exposure of an available-for-sale debt security.
 - c. With respect to cash flow hedges only:
 1. A nonderivative financial instrument as a hedging instrument in a foreign currency cash flow hedge.
 - d. With respect to net investment hedges only:
 1. A compound derivative instrument that has multiple underlyings—one based on foreign exchange risk and one or more not based on foreign exchange (for example, the price of gold or the price of an S&P 500 contract), except as indicated in paragraph 815-20-25-67 for certain cross-currency interest rate swaps
 2. A derivative instrument and a cash instrument in combination as a single hedging instrument (that is, an entity shall not consider a separate derivative instrument and a cash instrument as a single synthetic instrument for accounting purposes)
 3. Subparagraph not used

> Hedge Effectiveness

815-20-25-72 The hedge effectiveness criteria are organized as follows:

- a. Hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges
- b. Hedge effectiveness criterion applicable to fair value hedges only—~~effectiveness horizon~~
- c. Hedge effectiveness criteria applicable to cash flow hedges only
- d. Subparagraph superseded by Accounting Standards Update No. 2017-12. Time value in net investment hedges.

815-20-25-73 Sections 815-25-55 and 815-30-55 illustrate some ways in which an entity may assess hedge effectiveness ~~and measures hedge ineffectiveness~~ for specific strategies. The Examples are not intended to imply that other reasonable methods are precluded. However, not all possible methods are reasonable or consistent with this Subtopic. Those Sections also discuss some methods of assessing hedge effectiveness ~~and determining hedge ineffectiveness~~ that are not consistent with this Subtopic and thus may not be used.

> > Hedge Effectiveness Criteria Applicable to both Fair Value Hedges and Cash Flow Hedges

815-20-25-74 This guidance addresses hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges.

815-20-25-75 To qualify for hedge accounting, the hedging relationship, both at inception of the hedge and on an ongoing basis, shall be expected to be highly effective in achieving either of the following:

- a. Offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated (if a fair value hedge)
- b. Offsetting cash flows attributable to the hedged risk during the term of the hedge (if a cash flow hedge), except as indicated in paragraph 815-20-25-50.

815-20-25-76 If the hedging instrument (such as an at-the-money option contract) provides only one-sided offset of the hedged risk, either of the following conditions shall be met:

- a. The increases (or decreases) in the fair value of the hedging instrument are expected to be highly effective in offsetting the decreases (or increases) in the fair value of the hedged item (if a fair value hedge).
- b. The cash inflows (outflows) from the hedging instrument are expected to be highly effective in offsetting the corresponding change in the cash outflows or inflows of the hedged transaction (if a cash flow hedge).

815-20-25-77 ~~Hedge ineffectiveness would result from~~ There would be a mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction in any of the following circumstances, among others:

- a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction, to the extent that those bases do not move in tandem
- b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in any of the following:
 - 1. Notional amounts

2. Maturities
 3. Quantity
 4. Location (not applicable for hedging relationships in which the variability in cash flows attributable to changes in a **contractually specified component** is designated as the hedged risk)
 5. Delivery dates.
- c. A change in the counterparty's creditworthiness.

815-20-25-78 Paragraph 815-20-55-62 discusses basis differences in cash flow hedges of interest rate risk.

815-20-25-79 An entity shall consider hedge effectiveness in two different ways—in prospective considerations and in retrospective evaluations:

- a. Prospective considerations. The entity's expectation that the relationship will be highly effective over future periods in achieving offsetting changes in fair value or cash flows, which is forward-looking, must be assessed on a quantitative basis at hedge inception unless one of the exceptions in paragraph 815-20-25-3(b)(2)(iv)(01) is met. Prospective assessments shall be subsequently performed whenever financial statements or earnings are reported and at least every three months. The entity shall elect at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(03) whether to perform subsequent assessments on a quantitative or qualitative basis. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of hedge effectiveness. A quantitative assessment can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. The quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the period used to assess whether the requirement for expectation of highly effective offset is satisfied. The quantitative prospective assessment may ~~shall~~ not be limited only to the likely or expected changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument or the hedged items. Generally, the process of formulating an expectation regarding the effectiveness of a proposed hedging relationship involves a probability-weighted analysis of the possible changes in fair value (if a fair value hedge) or in fair value or cash flows (if a cash flow hedge) of the derivative instrument and the hedged items for the hedge period. Therefore, a probable future change in fair value will be more heavily weighted than a reasonably possible future change. That calculation technique is consistent with the definition of the term **expected cash flow** in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*.

- b. Retrospective evaluations. An assessment of effectiveness ~~shall~~ may be performed on a quantitative or qualitative basis on the basis of the entity's election at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(03). That assessment shall be performed whenever financial statements or earnings are reported, and at least every three months. See paragraphs 815-20-35-2 through 35-4 for further guidance. At inception of the hedge, an entity electing a dollar-offset approach to perform retrospective evaluations on a quantitative basis may choose either a period-by-period approach or a cumulative approach in designating how effectiveness of a fair value hedge or of a cash flow hedge will be assessed retrospectively under that approach, depending on the nature of the hedge documented in accordance with paragraph 815-20-25-3. For example, an entity may decide that the cumulative approach is generally preferred, yet may wish to use the period-by-period approach in certain circumstances. See paragraphs 815-20-35-5 through ~~35-6~~ 35-7 for further guidance.

815-20-25-79A See paragraphs 815-20-25-139 through 25-142 about the timing of hedge effectiveness assessments required by paragraph 815-20-25-79 for a private company that is not a financial institution or a not-for-profit entity (except for a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market).

815-20-25-80 All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship. An entity shall use the quantitative effectiveness assessment method defined at hedge inception consistently ~~throughout the hedge period to do both of the following:~~ for the periods that the entity either elects or is required to assess hedge effectiveness on a quantitative basis.

- a. Subparagraph superseded by Accounting Standards Update No. 2017-12. Assess at inception of the hedge and on an ongoing basis whether it expects the hedging relationship to be highly effective in achieving offset
- b. Subparagraph superseded by Accounting Standards Update No. 2017-12. Measure the ineffective part of the hedge.

815-20-25-81 This Subtopic does not specify a single method for ~~either assessing whether a hedge is expected to be highly effective or measuring hedge ineffectiveness.~~ The method of assessing effectiveness shall be reasonable. The appropriateness of a given method of assessing hedge effectiveness depends on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, an entity shall assess effectiveness for similar hedges in a similar manner, including whether a component of the gain or loss on a derivative instrument is excluded in assessing effectiveness for similar hedges. Use of different methods for similar hedges shall be justified. The mechanics of isolating

the change in **time value of an option** discussed beginning in paragraph 815-20-25-98 also shall be applied consistently.

815-20-25-82 In defining how hedge effectiveness will be assessed, an entity shall specify whether it will include in that assessment all of the gain or loss on a hedging instrument. An entity may exclude all or a part of the hedging instrument's time value from the assessment of hedge effectiveness, as follows:

- a. If the effectiveness of a hedge with an option is assessed based on changes in the option's intrinsic value, the change in the time value of the option would be excluded from the assessment of hedge effectiveness.
- b. If the effectiveness of a hedge with an option is assessed based on changes in the option's minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract shall be excluded from the assessment of hedge effectiveness.
- c. An entity may exclude any of the following components of the change in an option's time value from the assessment of hedge effectiveness:
 1. The portion of the change in time value attributable to the passage of time (theta)
 2. The portion of the change in time value attributable to changes due to volatility (vega)
 3. The portion of the change in time value attributable to changes due to interest rates (rho).
- d. If the effectiveness of a hedge with a forward contract or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price shall be excluded from the assessment of hedge effectiveness.
- e. An entity may exclude the portion of the change in fair value of a currency swap attributable to a cross-currency basis spread.

815-20-25-83 ~~Changes in the excluded component shall be included currently in earnings, together with any ineffectiveness that results under the defined method of assessing ineffectiveness.~~ No other components of a gain or loss on the designated hedging instrument shall be excluded from the assessment of hedge effectiveness nor shall an entity exclude any aspect of a change in an option's value from the assessment of hedge effectiveness that is not one of the permissible components of the change in an option's time value. For example, an entity shall not exclude from the assessment of hedge effectiveness the portion of the change in time value attributable to changes in other market variables (that is, other than rho and vega).

815-20-25-83A For fair value and cash flow hedges, the initial value of the component excluded from the assessment of effectiveness shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded

component and amounts recognized in earnings under that systematic and rational method shall be recognized in other comprehensive income. Example 31 beginning in paragraph 815-20-55-235 illustrates this approach for a cash flow hedge in which the hedging instrument is an option and the entire time value is excluded from the assessment of effectiveness.

815-20-25-83B For fair value and cash flow hedges, an entity alternatively may elect to record changes in the fair value of the excluded component currently in earnings. This election shall be applied consistently to similar hedges in accordance with paragraph 815-20-25-81 and shall be disclosed in accordance with paragraph 815-10-50-4EEEE.

815-20-25-84 ~~Whether a hedging relationship qualifies as highly effective sometimes will be easy to assess, and there will be no ineffectiveness to recognize in earnings during the term of the hedge. If the critical terms of the hedging instrument and of the entire hedged item asset or liability (as opposed to selected cash flows) or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecasted purchase of a commodity with a forward contract will be highly perfectly effective and that there will be no ineffectiveness to be recognized in earnings if all of the following criteria are met:~~

- a. The forward contract is for purchase of the same quantity of the same commodity at the same time and location as the hedged forecasted purchase. Location differences do not need to be considered if an entity designates the variability in cash flows attributable to changes in a contractually specified component as the hedged risk and the requirements in paragraphs 815-20-25-22A through 25-22B are met.
- b. The fair value of the forward contract at inception is zero.
- c. Either of the following criteria is met:
 1. The change in the discount or premium on the forward contract is excluded from the assessment of effectiveness ~~and included directly in earnings pursuant to paragraphs 815-20-25-81 through 25-83.~~
 2. The change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

815-20-25-84A In a cash flow hedge of a group of forecasted transactions in accordance with paragraph 815-20-25-15(a)(2), an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 815-20-25-84(a) if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month.

815-20-25-85 If all of the criteria in ~~the preceding paragraph~~ paragraphs 815-20-25-84 through 25-84A are met, an entity shall still perform and document an assessment of hedge effectiveness at the inception of the hedging relationship and, as discussed beginning in paragraph 815-20-35-9, on an ongoing basis throughout the hedge period. No quantitative effectiveness assessment is required at hedge inception if the criteria in paragraphs 815-20-25-84 through 25-84A are met (see paragraph 815-20-25-3(b)(2)(iv)(01)).

815-20-25-86 The remainder of this guidance on hedge effectiveness criteria applicable to both fair value hedges and cash flow hedges is organized as follows:

- a. Hedge effectiveness when the hedging instrument is an option or combination of options
- b. Hedge effectiveness when hedged exposure is more limited than hedging instrument
- c. Hedge effectiveness during designated hedge period
- d. Assuming perfect effectiveness ~~no hedge ineffectiveness~~ in a hedge with an interest rate swap (the shortcut method).

> > > Hedge Effectiveness When the Hedging Instrument Is an Option or Combination of Options

815-20-25-87 The hedge effectiveness criteria applicable to options and combinations of options are organized as follows:

- a. Determining whether a combination of options is net written
- b. Hedge effectiveness of written options
- c. Hedge effectiveness of options in general.

> > > Determining Whether a Combination of Options Is Net Written

815-20-25-88 This guidance addresses how an entity shall determine whether a combination of options is considered a net written option subject to the requirements of paragraph 815-20-25-94. A combination of options (for example, an interest rate collar) entered into contemporaneously shall be considered a written option if either at inception or over the life of the contracts a net premium is received in cash or as a favorable rate or other term. Furthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option. The determination of whether a combination of options is considered a net written option depends in part on whether strike prices and notional amounts of the options remain constant.

> > > > Strike Prices and Notional Amounts Remain Constant

815-20-25-89 For a combination of options in which the strike price and the notional amount in both the written option component and the purchased option component remain constant over the life of the respective component, that combination of options would be considered a net purchased option or a zero cost collar (that is, the combination shall not be considered a net written option subject to the requirements of paragraph 815-20-25-94) provided all of the following conditions are met:

- a. No net premium is received.
- b. The components of the combination of options are based on the same underlying.
- c. The components of the combination of options have the same maturity date.
- d. The notional amount of the written option component is not greater than the notional amount of the purchased option component.

815-20-25-90 If the combination of options does not meet all of those conditions, it shall be subject to the test in paragraph 815-20-25-94. For example, a combination of options having different underlying indexes, such as a collar containing a written floor based on three-month U.S. Treasury rates and a purchased cap based on three-month London Interbank Offered Rate (LIBOR), shall not be considered a net purchased option or a zero cost collar even though those rates may be highly correlated.

> > > > Strike Prices and Notional Amounts Do Not Remain Constant

815-20-25-91 If either the written option component or the purchased option component for a combination of options has either strike prices or notional amounts that do not remain constant over the life of the respective component, the assessment to determine whether that combination of options can be considered not to be a written option under paragraph 815-20-25-88 shall be evaluated with respect to each date that either the strike prices or the notional amounts change within the contractual term from inception to maturity.

815-20-25-92 Even though that assessment is made on the date that a combination of options is designated as a hedging instrument (to determine the applicability of paragraph 815-20-25-94), it shall consider the receipt of a net premium (in cash or as a favorable rate or other term) from that combination of options at each point in time that either the strike prices or the notional amounts change, such as either of the following circumstances:

- a. If strike prices fluctuate over the life of a combination of options and no net premium is received at inception, a net premium will typically be received as a favorable term in one or more reporting periods within the contractual term from inception to maturity.
- b. If notional amounts fluctuate over the life of a combination of options and no net premium is received at inception, a net premium or a favorable term will typically be received in one or more periods within the contractual term from inception to maturity.

815-20-25-93 In addition, a combination of options in which either the written option component or the purchased option component has either strike prices or notional amounts that do not remain constant over the life of the respective component shall satisfy all of the conditions in paragraph 815-20-25-89 to be considered not to be a written option (that is, to be considered to be a net purchased option or zero cost collar) under paragraph 815-20-25-88. For example, if the notional amount of the written option component is greater than the notional amount of the purchased option component at any date that the notional amount changes within the contractual term from inception to maturity, the combination of options shall be considered to be a written option under paragraph 815-20-25-88 and, thus, subject to the criteria in the following paragraph.

> > > Hedge Effectiveness of Written Options

815-20-25-94 If a written option is designated as hedging a recognized asset or liability or an unrecognized firm commitment (if a fair value hedge) or the variability in cash flows for a recognized asset or liability or an unrecognized firm commitment (if a cash flow hedge), the combination of the hedged item and the written option provides either of the following:

- a. At least as much potential for gains as a result of a favorable change in the fair value of the combined instruments (that is, the written option and the hedged item, such as an embedded purchased option) as exposure to losses from an unfavorable change in their combined fair value (if a fair value hedge)
- b. At least as much potential for favorable cash flows as exposure to unfavorable cash flows (if a cash flow hedge).

815-20-25-95 The written-option test in the preceding paragraph shall be applied only at inception of the hedging relationship and is met if all possible percentage favorable changes in the underlying (from zero percent to 100 percent) would provide either of the following:

- a. At least as much gain as the loss that would be incurred from an unfavorable change in the underlying of the same percentage (if a fair value hedge)

- b. At least as much favorable cash flows as the unfavorable cash flows that would be incurred from an unfavorable change in the underlying of the same percentage (if a cash flow hedge).

815-20-25-96 The time value of a written option (or net written option) may be excluded from the written-option test if, in defining how hedge effectiveness will be assessed, the entity specifies that it will base that assessment on only changes in the option's intrinsic value. In that circumstance, the change in the time value of the options would be excluded from the assessment of hedge effectiveness in accordance with paragraph 815-20-25-82(a).

815-20-25-97 When applying the written-option test to determine whether there is symmetry of the gain and loss potential of the combined hedged position for all possible percentage changes in the underlying, an entity is permitted to measure the change in the intrinsic value of the written option (or net written option) combined with the change in fair value of the hedged item.

> > > Computing Changes in an Option's Time Value

815-20-25-98 In computing the changes in an option's time value that would be excluded from the assessment of hedge effectiveness, an entity shall use a technique that appropriately isolates those aspects of the change in time value. Generally, to allocate the total change in an option's time value to its different aspects—the passage of time and the market variables—the change in time value attributable to the first aspect to be isolated is determined by holding all other aspects constant as of the beginning of the period. Each remaining aspect of the change in time value is then determined in turn in a specified order based on the ending values of the previously isolated aspects.

815-20-25-99 Based on that general methodology, if only one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta), that aspect shall be the first aspect for which the change in time value is computed and would be determined by holding all other parameters constant for the period used for assessing hedge effectiveness. However, if more than one aspect of the change in time value is excluded from the assessment of hedge effectiveness (for example, theta and vega), an entity shall determine the amount of that change in time value by isolating each of those two aspects in turn in a prespecified order (one first, the other second). The second aspect to be isolated would be based on the ending value of the first isolated aspect and the beginning values of the remaining aspects. The portion of the change in time value that is included in the assessment of effectiveness shall be determined by deducting from the total change in time value the portion of the change in time value attributable to excluded components.

> > > Hedge Effectiveness When Hedged Exposure Is More Limited Than Hedging Instrument

815-20-25-100 An entity may designate as the hedging instrument in a fair value hedge or cash flow hedge a derivative instrument that does not have a limited exposure comparable to the limited exposure of the hedged item to the risk being hedged. However, to make that designation, in accordance with paragraph 815-20-25-75, the entity shall establish that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated. See paragraph 815-20-25-79(a) for additional guidance on prospective considerations of hedge effectiveness in this circumstance.

> > > Hedge Effectiveness during Designated Hedge Period

815-20-25-101 It is inappropriate under this Subtopic for an entity to designate a derivative instrument as the hedging instrument if the entity expects that the derivative instrument will not be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period that the hedge is designated, unless the entity has documented undertaking a dynamic hedging strategy in which it has committed itself to an ongoing repositioning strategy for its hedging relationship.

> > > Assuming No Perfect Hedge Effectiveness ~~ineffectiveness~~ in a Hedge with an Interest Rate Swap (the Shortcut Method)

815-20-25-102 The conditions for the shortcut method do not determine which hedging relationships qualify for hedge accounting; rather, those conditions determine which hedging relationships qualify for a shortcut version of hedge accounting that assumes perfect ~~does not immediately recognize hedge effectiveness ineffectiveness~~. If all of the applicable conditions in the list in paragraph 815-20-25-104 are met, an entity may assume perfect effectiveness ~~no ineffectiveness~~ in a hedging relationship of interest rate risk involving a recognized interest-bearing asset or liability (or a firm commitment arising on the trade [pricing] date to purchase or issue an interest-bearing asset or liability) and an interest rate swap (or a compound hedging instrument composed of an interest rate swap and a mirror-image call or put option as discussed in paragraph 815-20-25-104[e]) provided that, in the case of a firm commitment, the trade date of the asset or liability differs from its settlement date due to generally established conventions in the marketplace in which the transaction is executed. ~~Given the potential for not recognizing hedge ineffectiveness in earnings under the shortcut method, its~~ The shortcut method's application shall be limited to hedging relationships that meet each and every applicable condition. That is, all the conditions applicable to fair value hedges shall be met to apply the shortcut method to a fair value hedge, and all the conditions applicable to cash flow hedges shall be met to apply the shortcut

method to a cash flow hedge. A hedging relationship cannot qualify for application of the shortcut method based on an assumption of ~~no ineffectiveness~~ perfect effectiveness justified by applying other criteria. The verb *match* is used in the specified conditions in the list to mean *be exactly the same* or *correspond exactly*.

815-20-25-103 Implicit in the conditions for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows. In applying the shortcut method, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity.

815-20-25-104 All of the following conditions apply to both fair value hedges and cash flow hedges:

- a. The notional amount of the interest rate swap matches the principal amount of the interest-bearing asset or liability being hedged.
- b. If the hedging instrument is solely an interest rate swap, the fair value of that interest rate swap at the inception of the hedging relationship must be zero, with one exception. The fair value of the swap may be other than zero at the inception of the hedging relationship only if the swap was entered into at the relationship's inception, the transaction price of the swap was zero in the entity's principal market (or most advantageous market), and the difference between transaction price and fair value is attributable solely to differing prices within the bid-ask spread between the entry transaction and a hypothetical exit transaction. The guidance in the preceding sentence is applicable only to transactions considered *at market* (that is, transaction price is zero exclusive of commissions and other transaction costs, as discussed in paragraph 820-10-35-9B). If the hedging instrument is solely an interest rate swap that at the inception of the hedging relationship has a positive or negative fair value, but does not meet the one exception specified in this paragraph, the shortcut method shall not be used even if all the other conditions are met.
- c. If the hedging instrument is a compound derivative composed of an interest rate swap and mirror-image call or put option as discussed in (e), the premium for the mirror-image call or put option shall be paid or received in the same manner as the premium on the call or put option embedded in the hedged item based on the following:
 1. If the implicit premium for the call or put option embedded in the hedged item is being paid principally over the life of the hedged item (through an adjustment of the interest rate), the fair value of the hedging instrument at the inception of the hedging relationship shall be zero (except as discussed previously in (b) regarding differing prices due to the existence of a bid-ask spread).
 2. If the implicit premium for the call or put option embedded in the hedged item was principally paid at inception-acquisition (through an

- original issue discount or premium), the fair value of the hedging instrument at the inception of the hedging relationship shall be equal to the fair value of the mirror-image call or put option.
- d. The formula for computing net settlements under the interest rate swap is the same for each net settlement. That is, both of the following conditions are met:
 1. The fixed rate is the same throughout the term.
 2. The variable rate is based on the same index and includes the same constant adjustment or no adjustment. The existence of a **stub period** and **stub rate** is not a violation of the criterion in (d) that would preclude application of the shortcut method if the stub rate is the variable rate that corresponds to the length of the stub period.
 - e. The interest-bearing asset or liability is not prepayable, that is, able to be settled by either party before its scheduled maturity or the assumed maturity date if the hedged item is measured in accordance with paragraph 815-25-35-13B, with the following qualifications:
 1. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to an embedded call option (put option) if the hedging instrument is a compound derivative composed of an interest rate swap and a mirror-image call option (put option).
 2. The call option embedded in the interest rate swap is considered a mirror image of the call option embedded in the hedged item if all of the following conditions are met:
 - i. The terms of the two call options match exactly, including all of the following:
 01. Maturities
 02. Strike price (that is, the actual amount for which the debt instrument could be called) and there is no termination payment equal to the deferred debt issuance costs that remain unamortized on the date the debt is called
 03. Related notional amounts
 04. Timing and frequency of payments
 05. Dates on which the instruments may be called.
 - ii. The entity is the writer of one call option and the holder (purchaser) of the other call option.
 - iii. Subparagraph not used.
 - f. Subparagraph superseded by Accounting Standards Update No. 2017-12. The index on which the variable leg of the interest rate swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship. [Content moved to paragraph 815-20-25-105(f) and amended and moved to paragraph 815-20-25-106(g)]
 - g. Any other terms in the interest-bearing financial instruments or interest rate swaps meet both of the following conditions:
 1. The terms are typical of those instruments.

2. The terms do not invalidate the assumption of perfect effectiveness
~~no ineffectiveness~~.

815-20-25-105 All of the following incremental conditions apply to fair value hedges only:

- a. The expiration date of the interest rate swap matches the maturity date of the interest-bearing asset or liability or the assumed maturity date if the hedged item is measured in accordance with paragraph 815-25-35-13B.
- b. There is no floor or cap on the variable interest rate of the interest rate swap.
- c. The interval between repricings of the variable interest rate in the interest rate swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).
- d. For fair value hedges of a proportion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument (see (a) in ~~the preceding~~ paragraph 815-20-25-104) matches the portion of the asset or liability being hedged.
- e. For fair value hedges of portfolios (or proportions thereof) of similar interest-bearing assets or liabilities, both of the following criteria are met:
 1. The notional amount of the interest rate swap designated as the hedging instrument matches the aggregate notional amount of the hedged item (whether it is all or a proportion of the total portfolio).
 2. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual assets or liabilities in the portfolio.
- f. The index on which the variable leg of the interest rate swap is based matches the benchmark interest rate designated as the interest rate risk being hedged for that hedging relationship. **[Content moved from paragraph 815-20-25-104(f)]**

815-20-25-106 All of the following incremental conditions apply to cash flow hedges only:

- a. All interest receipts or payments on the variable-rate asset or liability during the term of the interest rate swap are designated as hedged.
- b. No interest payments beyond the term of the interest rate swap are designated as hedged.
- c. Either of the following conditions is met:
 1. There is no floor or cap on the variable interest rate of the interest rate swap.
 2. The variable-rate asset or liability has a floor or cap and the interest rate swap has a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-rate asset or liability.

For purposes of this paragraph, comparable does not necessarily mean equal. For example, if an interest rate swap's variable rate is based on LIBOR and an asset's variable rate is LIBOR plus 2 percent, a 10 percent cap on the interest rate swap would be comparable to a 12 percent cap on the asset.

- d. The repricing dates of the variable-rate asset or liability and the hedging instrument must occur on the same dates and be calculated the same way (that is, both shall be either prospective or retrospective). If the repricing dates of the hedged item occur on the same dates as the repricing dates of the hedging instrument but the repricing calculation for the hedged item is prospective whereas the repricing calculation for the hedging instrument is retrospective, those repricing dates do not match.
- e. For cash flow hedges of the interest payments on only a portion of the principal amount of the interest-bearing asset or liability, the notional amount of the interest rate swap designated as the hedging instrument (see paragraph 815-20-25-104(a)) matches the principal amount of the portion of the asset or liability on which the hedged interest payments are based.
- f. For a cash flow hedge in which the hedged forecasted transaction is a group of individual transactions (as permitted by paragraph 815-20-25-15(a)), if both of the following criteria are met:
 - 1. The notional amount of the interest rate swap designated as the hedging instrument (see paragraph 815-20-25-104(a)) matches the notional amount of the aggregate group of hedged transactions.
 - 2. The remaining criteria for the shortcut method are met with respect to the interest rate swap and the individual transactions that make up the group. For example, the interest rate repricing dates for the variable-rate assets or liabilities whose interest payments are included in the group of forecasted transactions shall match (that is, be exactly the same as) the reset dates for the interest rate swap.
- g. The index on which the variable leg of the interest rate swap is based matches the ~~benchmark~~ contractually specified interest rate designated as the interest rate ~~risk~~ being hedged for that hedging relationship. **[Content amended as shown and moved from paragraph 815-20-25-104(f)]**

815-20-25-107 The shortcut method may be applied to a hedging relationship that involves the use of an interest rate swap-in-arrears provided all of the applicable conditions are met.

815-20-25-108 Any discount or premium in hedged debt's carrying amount (including any related deferred issuance costs) is irrelevant to and has no direct impact on the determination of whether an interest rate swap contains a mirror-image call option under paragraph 815-20-25-104(e). Typically, the call price is greater than the par or **face amount** of the debt instrument. The carrying amount

of the debt is economically unrelated to the amount the issuer would be required to pay to exercise the call embedded in the debt.

815-20-25-109 The fixed interest rate on a hedged item need not exactly match the fixed interest rate on an interest rate swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on an interest rate swap designated as a cash flow hedge. An interest rate swap's fair value comes from its net settlements. The fixed and variable interest rates on an interest rate swap can be changed without affecting the net settlement if both are changed by the same amount. That is, an interest rate swap with a payment based on LIBOR and a receipt based on a fixed rate of 5 percent has the same net settlements and fair value as an interest rate swap with a payment based on LIBOR plus 1 percent and a receipt based on a fixed rate of 6 percent.

815-20-25-110 Paragraph not used.

815-20-25-111 Comparable credit risk at inception is not a condition for assuming perfect effectiveness ~~no ineffectiveness~~ even though actually achieving perfect offset would require that the same discount rate be used to determine the fair value of the swap and of the hedged item or hedged transaction. To justify using the same discount rate, the credit risk related to both parties to the swap as well as to the debtor on the hedged interest-bearing asset (in a fair value hedge) or the variable-rate asset on which the interest payments are hedged (in a cash flow hedge) would have to be the same. However, because that complication is caused by the interaction of interest rate risk and credit risk, which are not easily separable, comparable creditworthiness is not considered a necessary condition for assuming perfect effectiveness ~~no ineffectiveness~~ in a hedge of interest rate risk.

> > > Application of Prepayable Criterion

815-20-25-112 An interest-bearing asset or liability shall be considered prepayable under the provisions of paragraph 815-20-25-104(e) if one party to the contract has the right to cause the payment of principal before the scheduled payment dates unless either of the following conditions is met:

- a. The debtor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always greater than the then fair value of the contract absent that right.
- b. The creditor has the right to cause settlement of the entire contract before its stated maturity at an amount that is always less than the then fair value of the contract absent that right.

815-20-25-113 However, none of the following shall be considered a prepayment provision:

- a. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event related to the debtor's credit deterioration or other change in the debtor's credit risk, such as any of the following:
 1. The debtor's failure to make timely payment, thus making it delinquent
 2. The debtor's failure to meet specific covenant ratios
 3. The debtor's disposition of specific significant assets (such as a factory)
 4. A declaration of cross-default
 5. A restructuring by the debtor.
- b. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause prepayment of the debt contingent upon the occurrence of a specific event that meets all of the following conditions:
 1. It is not probable at the time of debt issuance.
 2. It is unrelated to changes in benchmark interest ~~rates~~ rates, contractually specified interest rates, or any other market variable.
 3. It is related either to the debtor's or creditor's death or to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.
- c. Contingent acceleration clauses that permit the debtor to accelerate the maturity of an outstanding note only upon the occurrence of a specified event that meets all of the following conditions:
 1. It is not probable at the time of debt issuance.
 2. It is unrelated to changes in benchmark interest ~~rates~~ rates, contractually specified interest rates, or any other market variable.
 3. It is related to regulatory actions, legislative actions, or other similar events that are beyond the control of the debtor or creditor.

815-20-25-114 Furthermore, a right to cause a contract to be prepaid at its then fair value would not cause the interest-bearing asset or liability to be considered prepayable because that right would have a fair value of zero at all times and essentially would provide only liquidity to the holder.

815-20-25-115 Application of this guidance to specific debt instruments is illustrated in paragraph 815-20-55-75.

> > > Application of the Shortcut Method to a Portfolio of Hedged Items

815-20-25-116 Portfolio hedging cannot be used to circumvent the application of the shortcut method criteria beginning in paragraph 815-20-25-102 to a fair value hedge of an individual interest-bearing asset or liability. A portfolio of interest-bearing assets or interest-bearing liabilities cannot qualify for the shortcut method if it contains an interest-bearing asset or liability that individually cannot qualify for the shortcut method.

815-20-25-117 The fair value hedge requirements of paragraph 815-20-25-12(b)(1) ensure that the individual items in a portfolio share the same risk exposure and have fair value changes attributable to the hedged risk that are expected to respond in a generally proportionate manner to the overall fair value changes of the entire portfolio. That requirement restricts the types of portfolios that can qualify for portfolio hedging; however, it also permits the existence of a certain amount of ineffectiveness mismatch between the change in the fair value of the individual hedged items and the change in the fair value of the hedged portfolio attributable to the hedged risk in portfolios that do qualify. As a result, the assumption of perfect effectiveness no ineffectiveness required for the shortcut method generally is inappropriate for portfolio hedges of similar assets or liabilities that are not also nearly identical (except for their notional amounts). Application of the shortcut method to portfolios that meet the requirements of paragraph 815-20-25-12(b)(1) is appropriate only if the assets or liabilities in the portfolio meet the same stringent criteria in paragraphs 815-20-25-104(e), 815-20-25-104(g), and 815-20-25-105(a) as required for hedges of individual assets and liabilities.

> > > Application of Whether the Shortcut Method Was Not or No Longer Is Appropriate

815-20-25-117A In the period in which an entity determines that use of the shortcut method was not or no longer is appropriate, the entity may use a quantitative method to assess hedge effectiveness and measure hedge results without dedesignating the hedging relationship if both of the following criteria are met:

- a. The entity documented at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(04) 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.
- 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.

815-20-25-117B If the criterion in paragraph 815-20-25-117A(a) is not met, the hedging relationship shall be considered invalid in the period in which the criteria for the shortcut method were not met and in all subsequent periods. If the criterion in paragraph 815-20-25-117A(a) is met, the hedging relationship shall be considered invalid in all periods in which the criterion in paragraph 815-20-25-117A(b) is not met.

815-20-25-117C If an entity cannot identify the date on which the shortcut criteria ceased to be met, the entity shall perform the quantitative assessment of effectiveness documented at hedge inception for all periods since hedge inception.

815-20-25-117D The terms of the hedged item and hedging instrument used to assess effectiveness, in accordance with paragraph 815-20-25-117A(b), shall be those existing as of the date that the shortcut criteria ceased to be met. For cash flow hedges, if the hypothetical derivative method is used as a proxy for the hedged item, the value of the hypothetical derivative shall be set to zero as of hedge inception.

> > Hedge Effectiveness Criterion Applicable to Fair Value Hedges Only— Effectiveness Horizon

815-20-25-118 In documenting its risk management strategy for a fair value hedge, an entity may specify an intent to consider the possible changes (that is, not limited to the likely or expected changes) in value of the hedging derivative instrument and the hedged item only over a shorter period than the derivative instrument's remaining life in formulating its expectation that the hedging relationship will be highly effective in achieving offsetting changes in fair value for the risk being hedged. The entity does not need to contemplate the offsetting effect for the entire term of the hedging instrument.

> > > Consideration of Prepayment Risk Using the Last-of-Layer Method

815-20-25-118A In a fair value hedge of interest rate risk designated under the last-of-layer method in accordance with paragraph 815-20-25-12A, an entity may exclude prepayment risk when measuring the change in fair value of the hedged item attributable to interest rate risk.

> > Hedge Effectiveness Criteria Applicable to Cash Flow Hedges Only

815-20-25-119 The hedge effectiveness criteria applicable to cash flow hedges only are organized as follows:

- a. Consideration of the time value of money
- b. Consideration of counterparty credit risk

- c. Additional considerations for options in cash flow hedges
- d. Assuming ~~no perfect hedge effectiveness~~ ineffectiveness in a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap recorded under the simplified hedge accounting approach.

> > > Consideration of the Time Value of Money

815-20-25-120 In assessing the effectiveness of a cash flow hedge, an entity generally shall consider the time value of money, especially if the hedging instrument involves periodic cash settlements.

815-20-25-121 An example of a situation in which an entity likely would reflect the time value of money is a tailing strategy with futures contracts. When using a tailing strategy, an entity adjusts the size or contract amount of futures contracts used in a hedge so that earnings (or expense) from reinvestment (or funding) of daily settlement gains (or losses) on the futures do not distort the results of the hedge. To assess offset of expected cash flows when a tailing strategy has been used, an entity could reflect the time value of money, perhaps by comparing the present value of the hedged forecasted cash flow with the results of the hedging instrument.

> > > Consideration of Counterparty Credit Risk

815-20-25-122 For a cash flow hedge, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative instrument that require the counterparty to make payments to the entity. Paragraph 815-20-35-14 states that, for an entity to conclude on an ongoing basis that a cash flow hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. See paragraphs 815-20-35-14 through 35-18 for further guidance.

> > > Additional Considerations for Options in Cash Flow Hedges

815-20-25-123 When an entity has documented that the effectiveness of a cash flow hedge will be assessed based on changes in the hedging option's intrinsic value pursuant to paragraph 815-20-25-82(a), that assessment (and the related cash flow hedge accounting) shall be performed for all changes in intrinsic value—that is, for all periods of time when the option has an intrinsic value, such as when the underlying is above the strike price of the call option.

815-20-25-124 When a purchased option is designated as a hedging instrument in a cash flow hedge, an entity shall not define only limited parameters for the risk exposure designated as being hedged that would include the time value component of that option. An entity cannot arbitrarily exclude some portion of an option's intrinsic value from the hedge effectiveness assessment simply through an articulation of the risk exposure definition. It is inappropriate to assert that only limited risk exposures are being hedged (for example, exposures related only to currency-exchange-rate changes above \$1.65 per pound sterling as illustrated in Example 26 [see paragraph 815-20-55-205]).

815-20-25-125 If an option is designated as the hedging instrument in a cash flow hedge, an entity may assess hedge effectiveness based on a measure of the difference, as of the end of the period used for assessing hedge effectiveness, between the strike price and forward price of the underlying, undiscounted. Although ~~assessment measurement~~ of cash flow hedge effectiveness with respect to an option designated as the hedging instrument in a cash flow hedge shall be performed by comparing the changes in present value of the expected future cash flows of the forecasted transaction to the change in fair value of the derivative instrument (aside from any excluded component under paragraph 815-20-25-82), that measure of changes in the expected future cash flows of the forecasted transaction based on forward rates, undiscounted, is not prohibited. With respect to an option designated as the hedging instrument in a cash flow hedge, assessing hedge effectiveness based on a similar measure with respect to the hedging instrument eliminates any difference that the effect of discounting may have on the hedging instrument and the hedged transaction. Pursuant to ~~paragraphs paragraph~~ 815-20-25-3(b)(2)(iv) and ~~25-3(b)(2)(v)~~, entities shall document the measure of intrinsic value that will be used in the assessment of hedge effectiveness. As discussed in paragraph 815-20-25-80, that measure must be used consistently for each period following designation of the hedging relationship.

> > > Assessing Hedge Effectiveness Based on an Option's Terminal Value

815-20-25-126 The guidance in paragraph 815-20-25-129 addresses a cash flow hedge that meets all of the following conditions:

- a. The hedging instrument is a purchased option or a combination of only options that comprise either a net purchased option or a zero-cost collar.
- b. The exposure being hedged is the variability in expected future cash flows attributed to a particular rate or price beyond (or within) a specified level (or levels).
- c. The assessment of effectiveness is documented as being based on total changes in the option's cash flows (that is, the assessment will include the hedging instrument's entire change in fair value, not just changes in intrinsic value).

815-20-25-127 This guidance has no effect on the accounting for fair value hedging relationships. In addition, in determining the accounting for seemingly similar cash flow hedging relationships, it would be inappropriate to analogize to this guidance.

815-20-25-128 For a hedging relationship that meets all of the conditions in paragraph 815-20-25-126, an entity may focus on the hedging instrument's terminal value (that is, its expected future pay-off amount at its maturity date) in determining whether the hedging relationship is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. An entity's focus on the hedging instrument's terminal value is not an impediment to the entity's subsequently deciding to dedesignate that cash flow hedge before the occurrence of the hedged transaction. If the hedging instrument is a purchased cap consisting of a series of purchased caplets that are each hedging an individual hedged transaction in a series of hedged transactions (such as caplets hedging a series of hedged interest payments at different monthly or quarterly dates), the entity may focus on the terminal value of each caplet (that is, the expected future pay-off amount at the maturity date of each caplet) in determining whether each of those hedging relationships is expected to be highly effective in achieving offsetting cash flows. The guidance in this paragraph applies to a purchased option regardless of whether at the inception of the cash flow hedging relationship it is at the money, in the money, or out of the money.

815-20-25-129 A hedging relationship that meets all of the conditions in paragraph 815-20-25-126 may be considered to be perfectly effective ~~(resulting in recognizing no ineffectiveness in earnings)~~ if all of the following conditions are met:

- a. The critical terms of the hedging instrument (such as its notional amount, underlying, maturity date, and so forth) completely match the related terms of the hedged forecasted transaction (such as the notional amount, the variable that determines the variability in cash flows, the expected date of the hedged transaction, and so forth).
- b. The strike price (or prices) of the hedging option (or combination of options) matches the specified level (or levels) beyond (or within) which the entity's exposure is being hedged.
- c. The hedging instrument's inflows (outflows) at its maturity date completely offset the change in the hedged transaction's cash flows for the risk being hedged.
- d. The hedging instrument can be exercised only on a single date—its contractual maturity date.

The condition in (d) is consistent with the entity's focus on the hedging instrument's terminal value. If the holder of the option chooses to pay for the ability to exercise the option at dates before the maturity date (for example, by acquiring an American-style option), the hedging relationship would not be perfectly effective ~~the potential for recognizing ineffectiveness exists.~~

815-20-25-129A In a hedge of a group of forecasted transactions in accordance with paragraph 815-20-25-15(a)(2), an entity may assume that the timing in which the hedged transactions are expected to occur and the maturity date of the hedging instrument match in accordance with paragraph 815-20-25-129(a) if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month.

> > > **Hedge Effectiveness of a Net-Purchased Combination of Options**

815-20-25-130 The guidance in the following paragraph addresses a cash flow hedging relationship that meets both of the following conditions:

- a. A combination of options (deemed to be a net purchased option) is designated as the hedging instrument.
- b. The effectiveness of the hedge is assessed based only on changes in intrinsic value of the hedging instrument (the combination of options).

815-20-25-131 The assessment of effectiveness of a cash flow hedging relationship meeting the conditions in the preceding paragraph may be based only on changes in the underlying that cause a change in the intrinsic value of the hedging instrument (the combination of options). Thus, the assessment can exclude ranges of changes in the underlying for which there is no change in the hedging instrument's intrinsic value.

~~>>>> **Assuming No Hedge Ineffectiveness in a Cash Flow Hedge of a Variable-Rate Borrowing with a Receive Variable, Pay-Fixed Interest Rate Swap Recorded under the Simplified Hedge Accounting Approach**~~

815-20-25-131A Paragraph superseded by Accounting Standards Update No. 2016-03.

815-20-25-131AA Paragraph superseded by Accounting Standards Update No. 2017-12. Paragraphs 815-10-35-1A through 35-1C, 815-10-50-3, 815-20-25-119, 815-20-25-131AB through 25-131E, 815-20-55-79A through 55-79B, 825-10-50-3, and 825-10-50-8 provide guidance for an entity electing the simplified hedge accounting approach. See paragraph 815-10-65-6 for transition guidance on applying the simplified hedge accounting approach. [Content amended and moved to paragraph 815-20-25-133]

815-20-25-131AB Paragraph superseded by Accounting Standards Update No. 2017-12. The conditions for the simplified hedge accounting approach determine which cash flow hedging relationships qualify for a simplified version of hedge accounting. If all of the conditions in paragraphs 815-20-25-131B and 815-20-25-131D are met, an entity may assume that there is no ineffectiveness in a cash flow hedging relationship involving a variable rate borrowing and a receive variable,

~~pay-fixed interest rate swap.~~ [Content amended and moved to paragraph 815-20-25-134]

815-20-25-131B Paragraph superseded by Accounting Standards Update No. 2017-12. ~~Provided all of the conditions in paragraph 815-20-25-131D are met, the simplified hedge accounting approach may be applied by a private company except for a financial institution as described in paragraph 942-320-50-1. An entity may elect the simplified hedge accounting approach for any receive variable, pay-fixed interest rate swap, provided that all of the conditions for applying the simplified hedge accounting approach specified in paragraph 815-20-25-131D are met. Implementation guidance on the conditions set forth in paragraph 815-20-25-131D is provided in paragraphs 815-20-55-79A through 55-79B.~~ [Content moved to paragraph 815-20-25-135]

815-20-25-131C Paragraph superseded by Accounting Standards Update No. 2017-12. ~~In applying the simplified hedge accounting approach, the documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed by the date on which the first annual financial statements are available to be issued after hedge inception rather than concurrently at hedge inception.~~ [Content moved to paragraph 815-20-25-136]

815-20-25-131D Paragraph superseded by Accounting Standards Update No. 2017-12. ~~An eligible entity under paragraph 815-20-25-131B must meet all of the following conditions to apply the simplified hedge accounting approach to a cash flow hedge of a variable rate borrowing with a receive variable, pay-fixed interest rate swap:~~

- ~~a. Both the variable rate on the swap and the borrowing are based on the same index and reset period (for example, both the swap and borrowing are based on one-month London Interbank Offered Rate [LIBOR] or both the swap and borrowing are based on three-month LIBOR). In complying with this condition, an entity is not limited to benchmark interest rates described in paragraph 815-20-25-6A.~~
- ~~b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a "plain-vanilla" swap), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.~~
- ~~c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.~~
- ~~d. The swap's fair value at inception (that is, at the time the derivative was executed to hedge the interest rate risk of the borrowing) is at or near zero.~~
- ~~e. The notional amount of the swap matches the principal amount of the borrowing being hedged. In complying with this condition, the amount of the borrowing being hedged may be less than the total principal amount of the borrowing.~~

- f. All interest payments occurring on the borrowing during the term of the swap (or the effective term of the swap underlying the forward starting swap) are designated as hedged whether in total or in proportion to the principal amount of the borrowing being hedged. **[Content amended and moved to paragraph 815-20-25-137]**

815-20-25-131E Paragraph superseded by Accounting Standards Update No. 2017-12. ~~A cash flow hedge established through the use of a forward starting receive variable, pay-fixed interest rate swap may be permitted in applying the simplified hedge accounting approach only if the occurrence of forecasted interest payments to be swapped is probable. When forecasted interest payments are no longer probable of occurring, a cash flow hedging relationship will no longer qualify for the simplified hedge accounting approach and the General Subsections of this Topic shall apply at the date of change and on a prospective basis. [Content moved to paragraph 815-20-25-138]~~

>> Time Value in Net Investment Hedges

815-20-25-132 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~The premium or discount (also referred to as the forward points) on a foreign currency forward contract that is used to hedge the foreign exchange exposure of the entity's net investment in foreign operations shall not be accounted for separately. Paragraphs 815-35-35-1 through 35-2 do not provide an entity with the option of separately amortizing the premium or discount on the forward exchange contract to earnings ratably over the period of the contract.~~

> Hedge Accounting Provisions Applicable to Certain Private Companies

>>>> >> Assuming No Perfect Hedge Effectiveness Ineffectiveness in a Cash Flow Hedge of a Variable-Rate Borrowing with a Receive-Variable, Pay-Fixed Interest Rate Swap Recorded under the Simplified Hedge Accounting Approach

815-20-25-133 Paragraphs 815-10-35-1A through 35-1C, 815-10-50-3, ~~815-20-25-3A, 815-20-25-119, 815-20-25-131AB through 25-131E 815-20-25-134 through 25-138, 815-20-55-79A through 55-79B, 825-10-50-3, and 825-10-50-8~~ provide guidance for an entity electing the simplified hedge accounting approach. See paragraph 815-10-65-6 for transition guidance on applying the simplified hedge accounting approach. **[Content amended as shown and moved from paragraph 815-20-25-131AA]**

815-20-25-134 The conditions for the simplified hedge accounting approach determine which cash flow hedging relationships qualify for a simplified version of hedge accounting. If all of the conditions in paragraphs ~~815-20-25-135 815-20-25-~~

~~131B and 815-20-25-137 815-20-25-131D~~ are met, an entity may assume perfect effectiveness ~~that there is no ineffectiveness~~ in a cash flow hedging relationship involving a variable-rate borrowing and a receive-variable, pay-fixed interest rate swap. **[Content amended as shown and moved from paragraph 815-20-25-131AB]**

815-20-25-135 Provided all of the conditions in paragraph ~~815-20-25-131D~~ 815-20-25-137 are met, the simplified hedge accounting approach may be applied by a **private company** except for a financial institution as described in paragraph 942-320-50-1. An entity may elect the simplified hedge accounting approach for any receive-variable, pay-fixed interest rate swap, provided that all of the conditions for applying the simplified hedge accounting approach specified in paragraph ~~815-20-25-131D~~ 815-20-25-137 are met. Implementation guidance on the conditions set forth in paragraph ~~815-20-25-131D~~ 815-20-25-137 is provided in paragraphs 815-20-55-79A through 55-79B. **[Content amended as shown and moved from paragraph 815-20-25-131B]**

815-20-25-136 In applying the simplified hedge accounting approach, the documentation required by paragraph 815-20-25-3 to qualify for hedge accounting must be completed by the date on which the first annual **financial statements are available to be issued** after hedge inception rather than concurrently at hedge inception. **[Content moved from paragraph 815-20-25-131C]**

815-20-25-137 An eligible entity under paragraph ~~815-20-25-131B~~ 815-20-25-135 must meet all of the following conditions to apply the simplified hedge accounting approach to a cash flow hedge of a variable-rate borrowing with a receive-variable, pay-fixed interest rate swap:

- a. Both the variable rate on the swap and the borrowing are based on the same index and reset period (for example, both the swap and borrowing are based on one-month London Interbank Offered Rate [LIBOR] or both the swap and borrowing are based on three-month LIBOR). ~~In complying with this condition, an entity is not limited to benchmark interest rates described in paragraph 815-20-25-6A.~~
- b. The terms of the swap are typical (in other words, the swap is what is generally considered to be a "plain-vanilla" swap), and there is no floor or cap on the variable interest rate of the swap unless the borrowing has a comparable floor or cap.
- c. The repricing and settlement dates for the swap and the borrowing match or differ by no more than a few days.
- d. The swap's fair value at inception (that is, at the time the derivative was executed to hedge the interest rate risk of the borrowing) is at or near zero.
- e. The notional amount of the swap matches the principal amount of the borrowing being hedged. In complying with this condition, the amount of

the borrowing being hedged may be less than the total principal amount of the borrowing.

- f. All interest payments occurring on the borrowing during the term of the swap (or the effective term of the swap underlying the forward starting swap) are designated as hedged whether in total or in proportion to the principal amount of the borrowing being hedged. **[Content amended as shown and moved from paragraph 815-20-25-131D]**

815-20-25-138 A cash flow hedge established through the use of a forward starting receive-variable, pay-fixed interest rate swap may be permitted in applying the simplified hedge accounting approach only if the occurrence of forecasted interest payments to be swapped is probable. When forecasted interest payments are no longer probable of occurring, a cash flow hedging relationship will no longer qualify for the simplified hedge accounting approach and the General Subsections of this Topic shall apply at the date of change and on a prospective basis. **[Content moved from paragraph 815-20-25-131E]**

> > Timing of Hedge Documentation for Certain Private Companies If Simplified Hedge Accounting Approach Is Not Applied

> > Concurrent Hedge Documentation

815-20-25-139 Concurrent with hedge inception, a **private company** that is not a financial institution as described in paragraph 942-320-50-1 shall document the following:

- a. The hedging relationship in accordance with paragraph 815-20-25-3(b)(1)
- b. The hedging instrument in accordance with paragraph 815-20-25-3(b)(2)(i)
- c. The hedged item in accordance with paragraph 815-20-25-3(b)(2)(ii), including (if applicable) firm commitments or forecasted transactions in paragraph 815-20-25-3(c) or (d)
- d. The nature of the risk being hedged in accordance with paragraph 815-20-25-3(b)(2)(iii).

815-20-25-140 A private company that is not a financial institution is not required to perform or document the following items concurrent with hedge inception but rather is required to perform or document them within the time periods discussed in paragraph 815-20-25-142:

- a. The method of assessing hedge effectiveness at inception and on an ongoing basis in accordance with paragraph 815-20-25-3(b)(2)(iv) and (vi)
- b. Initial hedge effectiveness assessments in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) through (04).

815-20-25-141 Example 1A beginning in paragraph 815-20-55-80A illustrates hedge documentation when the critical terms of the hedging instrument and hedged forecasted transaction match. Although that Example illustrates the documentation of the method of assessing hedge effectiveness, private companies that are not financial institutions may complete hedge documentation requirements in accordance with paragraphs 815-20-25-139 through 25-140.

> > Hedge Effectiveness Assessments

815-20-25-142 For a private company that is not a financial institution, the performance and documentation of the items listed in paragraph 815-20-25-140, as well as required subsequent quarterly hedge effectiveness assessments, may be completed before the date on which the next interim (if applicable) or annual financial statements are available to be issued. Even though the completion of the initial and ongoing assessments of effectiveness may be deferred to the date on which **financial statements are available to be issued** the assessments shall be completed using information applicable as of hedge inception and each subsequent quarterly assessment date when completing this documentation on a deferred basis. Therefore, the assessment should be performed to determine whether the hedge was highly effective at achieving offsetting changes in fair values or cash flows at inception and in each subsequent quarterly assessment period up to the reporting date.

> Hedge Accounting Provisions Applicable to Certain Not-for-Profit Entities

815-20-25-143 Not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market) may apply the guidance on the timing of hedge documentation in paragraphs 815-20-25-139 through 25-142. Specifically, those entities shall document the items listed in paragraph 815-20-25-139 concurrent with hedge inception, but they may perform and document the items listed in paragraph 815-20-25-140 within the time periods discussed in paragraph 815-20-25-142.

10. Amend paragraphs 815-20-35-1 through 35-2, 815-20-35-8 through 35-9 and the related heading, 815-20-35-11 through 35-12, 815-20-35-16, 815-20-35-19 and its related heading, add paragraphs 815-20-35-2A through 35-2G and their related headings, and supersede paragraphs 815-20-35-7, 815-20-35-13, and 815-20-35-17, with a link to transition paragraph 815-20-65-3, as follows:

Subsequent Measurement

815-20-35-1 Paragraph 815-10-35-2 states that the accounting for subsequent changes in the **fair value** (that is, gains or losses) of a **derivative instrument** depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, on the reason for holding it. Specifically, subsequent gains and losses on derivative instruments shall be accounted for as follows:

- a. No hedging designation. Paragraph 815-10-35-2 requires that the gain or loss on a derivative instrument not designated as a hedging instrument be recognized currently in earnings.
- b. **Fair value hedge.** The gain or loss on a derivative instrument designated and qualifying as a fair value hedging instrument as well as the offsetting loss or gain on the hedged item attributable to the hedged risk shall be recognized currently in earnings in the same accounting period, as provided in paragraphs 815-25-35-1 through 35-6. If an entity excludes a portion of the hedging instrument from the assessment of hedge effectiveness in accordance with paragraph 815-20-25-82, the initial value of the excluded component shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument with any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method recognized in other comprehensive income in accordance with paragraph 815-20-25-83A. An entity also may elect to recognize the excluded component of the gain or loss currently in earnings in accordance with paragraph 815-20-25-83B. The gain or loss on the hedging derivative or nonderivative instrument in a hedge of a foreign-currency-denominated **firm commitment** and the offsetting loss or gain on the hedged firm commitment shall be recognized currently in earnings in the same accounting period, ~~as provided in paragraphs 815-20-25-58 through 25-59.~~ The gain or loss on the hedging derivative instrument in a hedge of an available-for-sale debt security and the offsetting loss or gain on the hedged available-for-sale debt security shall be recognized currently in earnings in the same accounting period.
- c. **Cash flow hedge.** ~~The effective portion of the~~ gain or loss on a derivative instrument designated and qualifying as a cash flow hedging instrument shall be reported as a component of other comprehensive income (outside earnings) and reclassified into earnings in the same period or periods during which the hedged **forecasted transaction** affects earnings, as provided in paragraphs 815-30-35-3 and 815-30-35-38 through 35-41. ~~The remaining gain or loss on the derivative instrument, if any, shall be recognized currently in earnings, as provided in paragraph 815-30-35-3. If an entity's defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness (see paragraphs 815-20-25-81~~

~~through 25-83), that excluded component of the gain or loss shall be recognized currently in earnings. If an entity excludes a portion of the hedging instrument from the assessment of hedge effectiveness in accordance with paragraph 815-20-25-82, the initial value of the excluded component shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument with any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method recognized in other comprehensive income in accordance with paragraph 815-20-25-83A. An entity also may elect to recognize the excluded component of the gain or loss currently in earnings in accordance with paragraph 815-20-25-83B. The effective portion of the gain or loss on the hedging derivative instrument in a hedge of a forecasted foreign-currency-denominated **transaction** shall be reported as a component of other comprehensive income (outside earnings) and reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings, as provided in paragraph 815-20-25-65. The remaining gain or loss on the hedging instrument shall be recognized currently in earnings.~~

- d. Net investment hedge. The gain or loss on the hedging derivative or nonderivative hedging instrument in a hedge of a net investment in a foreign operation shall be reported in other comprehensive income (outside earnings) as part of the cumulative translation adjustment ~~to the extent it is effective as a hedge~~, as provided in paragraph 815-20-25-66. If an entity excludes a portion of the hedging instrument from the assessment of hedge effectiveness in accordance with paragraphs 815-35-35-5 through 35-5B, the initial value of the excluded component shall be recognized in earnings using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and the amounts recognized in earnings under that systematic and rational method shall be recognized in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of other comprehensive income) in accordance with paragraph 815-35-35-5A. An entity also may elect to recognize the excluded component of the gain or loss currently in earnings in accordance with paragraph 815-35-35-5B.

> Hedge Effectiveness—After Designation

815-20-35-2 If a fair value hedge or cash flow hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test on either a quantitative basis (using either a dollar-offset test or a statistical method such as regression analysis) or a qualitative basis. See paragraphs 815-20-35-2A through 35-2F for additional guidance on qualitative assessments of effectiveness and also would measure any ineffectiveness during

~~the hedge period. If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. At least quarterly, the hedging entity shall determine whether the hedging relationship has been highly effective in having achieved offsetting changes in fair value or cash flows through the date of the periodic assessment. That assessment can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information.~~
[Content amended and moved to paragraph 815-20-35-2G]

> > Effectiveness Assessments on a Qualitative Basis

815-20-35-2A An entity may qualitatively assess hedge effectiveness if both of the following criteria are met:

- a. An entity performs an initial quantitative test of hedge effectiveness on a prospective basis (that is, it is not assuming that the hedging relationship is perfectly effective at hedge inception as described in paragraph 815-20-25-3(b)(2)(iv)(01)(A) through (H)), and the results of that quantitative test demonstrate highly effective offset.
- b. At hedge inception, an entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods.

See paragraphs 815-20-55-79G through 55-79N for implementation guidance on factors to consider when determining whether qualitative assessments of effectiveness can be performed after hedge inception.

815-20-35-2B An entity may elect to qualitatively assess hedge effectiveness in accordance with paragraph 815-20-35-2A on a hedge-by-hedge basis. If an entity makes this qualitative assessment election, only the quantitative method specified in an entity's initial hedge documentation must comply with paragraph 815-20-25-81.

815-20-35-2C When an entity performs qualitative assessments of hedge effectiveness, it shall verify and document whenever financial statements or earnings are reported and at least every three months that the facts and circumstances related to the hedging relationship have not changed such that it can assert qualitatively that the hedging relationship was and continues to be highly effective. While not all-inclusive, the following is a list of indicators that may, individually or in the aggregate, allow an entity to continue to assert qualitatively that the hedging relationship is highly effective:

- a. An assessment of the factors that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis has not changed such that the entity can continue to assert qualitatively that the hedging relationship was and continues to be highly effective. This

shall include an assessment of the guidance in paragraph 815-20-25-100 when applicable.

- b. There have been no adverse developments regarding the risk of counterparty default.

815-20-35-2D If an entity elects to assess hedge effectiveness on a qualitative basis and then facts and circumstances change such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective in achieving offsetting changes in fair values or cash flows, the entity shall assess effectiveness of that hedging relationship on a quantitative basis in subsequent periods. In addition, an entity may perform a quantitative assessment of hedge effectiveness in any reporting period to validate whether qualitative assessments of hedge effectiveness remain appropriate. In both cases, the entity shall apply the quantitative method that it identified in its initial hedge documentation in accordance with paragraph 815-20-25-3(b)(2)(iv)(03).

815-20-35-2E When an entity determines that facts and circumstances have changed and it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective, the entity shall begin performing subsequent quantitative assessments of hedge effectiveness as of the period that the facts and circumstances changed. If there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship, the entity may begin performing quantitative assessments of effectiveness in the current period.

815-20-35-2F After performing a quantitative assessment of hedge effectiveness for one or more reporting periods as discussed in paragraphs 815-20-35-2D through 35-2E, an entity may revert to qualitative assessments of hedge effectiveness if it can reasonably support an expectation of high effectiveness on a qualitative basis for subsequent periods. See paragraphs 815-20-55-79G through 55-79N for implementation guidance on factors to consider when determining whether qualitative assessments of effectiveness can be performed after hedge inception.

> > Quantitative Hedge Effectiveness Assessments after Hedge Designation

815-20-35-2G That assessment Quantitative assessments can be based on regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. [Content amended as shown and moved from paragraph 815-20-35-2]

815-20-35-3 If an entity elects at the inception of a hedging relationship to use the same regression analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness, then during the term of that hedging relationship both of the following conditions shall be met:

- a. Those regression analysis calculations shall generally incorporate the same number of data points.
- b. That entity must periodically update its regression analysis (or other statistical analysis).

815-20-35-4 Electing to use a regression or other statistical analysis approach instead of a dollar-offset approach to perform retrospective evaluations of assessing hedge effectiveness may affect whether an entity can apply hedge accounting for the current assessment period.

815-20-35-5 In periodically (that is, at least quarterly) assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows) under a dollar-offset approach, an entity shall use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges):

- a. Period-by-period approach. The period-by-period approach involves comparing the changes in the hedging instrument's fair values (or cash flows) that have occurred during the period being assessed to the changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged that have occurred during the same period. If an entity elects to base its comparison of changes in fair value (or cash flows) on a period-by-period approach, the period cannot exceed three months. Fair value (or cash flow) patterns of the hedging instrument or the hedged item (or hedged transaction) in periods before the period being assessed are not relevant.
- b. Cumulative approach. The cumulative approach involves comparing the cumulative changes (to date from inception of the hedge) in the hedging instrument's fair values (or cash flows) to the cumulative changes in the hedged item's fair value (or hedged transaction's cash flows) attributable to the risk hedged.

815-20-35-6 If an entity elects at inception of a hedging relationship to base its comparison of changes in fair value (or cash flows) on a cumulative approach, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Electing to utilize a period-by-period approach instead of a cumulative approach (or vice versa) to perform retrospective evaluations of assessing hedge effectiveness under the dollar-offset method may affect whether an entity can apply hedge accounting for the current assessment period.

815-20-35-7 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~The preceding guidance relates to an entity's periodic retrospective assessment and determining whether a hedging relationship continues to qualify for hedge accounting; it does not relate to the actual measurement of hedge ineffectiveness to be recognized in earnings under hedge accounting. The actual measurement of ineffectiveness is based on the extent to which exact offset is not achieved as specified in paragraphs 815-25-35-1 through 35-4 for fair value hedges or paragraph 815-30-35-3 for cash flow hedges.~~

815-20-35-8 The remainder of this guidance is organized as follows:

- a. Assessing effectiveness based on whether the critical terms of the hedging instrument and hedged item match ~~Relative ease of assessing effectiveness~~
- b. Possibility of default by the counterparty to hedging derivative
- c. Change in hedge effectiveness method when hedge effectiveness is assessed on a quantitative basis.

> > Assessing Effectiveness Based on Whether the Critical Terms of the Hedging Instrument and Hedged Item Match ~~Relative Ease of Assessing Effectiveness~~

815-20-35-9 If, at inception, the critical terms of the hedging instrument and the hedged forecasted transaction are the same (see ~~paragraph~~ paragraphs 815-20-25-84 through 25-84A), the entity can conclude that changes in cash flows attributable to the risk being hedged are expected to be completely offset by the hedging derivative. Therefore, subsequent assessments can be performed by verifying and documenting whether the critical terms of the hedging instrument and the forecasted transaction have changed during the period in review.

815-20-35-10 Because the assessment of hedge effectiveness in a cash flow hedge involves assessing the likelihood of the counterparty's compliance with the contractual terms of the derivative instrument designated as the hedging instrument, the entity must also assess whether there have been adverse developments regarding the risk of counterparty default, particularly if the entity planned to obtain its cash flows by liquidating the derivative instrument at its fair value.

815-20-35-11 If there are no such changes in the critical terms or adverse developments regarding counterparty default, the entity may conclude that the hedging relationship is perfectly effective ~~there is no ineffectiveness to be recorded~~. In that case, the change in fair value of the derivative instrument can be viewed as a proxy for the present value of the change in cash flows attributable to the risk being hedged.

815-20-35-12 ~~In addition, However, the entity must assess whether the hedging relationship is expected to continue to be highly effective using a quantitative assessment method (using either a dollar-offset test or a statistical method such as regression analysis). However, the entity must measure the amount of ineffectiveness that must be recorded currently in earnings pursuant to the guidance beginning in paragraph 815-30-35-10 if any of the following conditions exist:~~ **[Content amended as shown and moved from paragraph 815-20-35-13]**

- a. The critical terms of the hedging instrument or the hedged forecasted transaction have changed.
- b. There have been adverse developments regarding the risk of counterparty default.

815-20-35-13 ~~Paragraph superseded by Accounting Standards Update No. 2017-12. In addition, the entity must assess whether the hedging relationship is expected to continue to be highly effective (using either a dollar offset test or a statistical method such as regression analysis).~~ **[Content amended and moved to paragraph 815-20-35-12]**

> > Possibility of Default by the Counterparty to Hedging Derivative

815-20-35-14 For an entity to conclude on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in cash flows, the entity shall not ignore whether it will collect the payments it would be owed under the contractual provisions of the derivative instrument. In complying with the requirements of paragraph 815-20-25-75(b), the entity shall assess the possibility of whether the counterparty to the derivative instrument will default by failing to make any contractually required payments to the entity as scheduled in the derivative instrument. In making that assessment, the entity shall also consider the effect of any related collateralization or financial guarantees. The entity shall be aware of the counterparty's creditworthiness (and changes therein) in determining the fair value of the **derivative instrument**. Although a change in the counterparty's creditworthiness would not necessarily indicate that the counterparty would default on its obligations, such a change shall warrant further evaluation.

815-20-35-15 If the likelihood that the counterparty will not default ceases to be probable, an entity would be unable to conclude that the hedging relationship in a cash flow hedge is expected to be highly effective in achieving offsetting cash flows.

815-20-35-16 In contrast, a change in the creditworthiness of the derivative instrument's counterparty in a fair value hedge would have an immediate impact effect because that change in creditworthiness would affect the change in the

derivative instrument's fair value, which would immediately affect both of the following:

- a. The assessment of whether the relationship qualifies for hedge accounting
- b. The amount of ~~ineffectiveness~~ mismatch between the change in the fair value of the hedging instrument and the hedged item attributable to the hedged risk recognized in earnings under fair value hedge accounting.

815-20-35-17 ~~Paragraph superseded by Accounting Standards Update No. 2017-12. A change in the creditworthiness of the derivative instrument's counterparty in a cash flow hedge of interest rate risk would also have an immediate impact if ineffectiveness were measured under the change in fair value method discussed beginning in paragraph 815-30-35-31.~~

815-20-35-18 Paragraph 815-20-25-103 states that, in applying the shortcut method, an entity shall consider the likelihood of the counterparty's compliance with the contractual terms of the hedging derivative that require the counterparty to make payments to the entity. That paragraph explains that implicit in the criteria for the shortcut method is the requirement that a basis exist for concluding on an ongoing basis that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair values or cash flows.

> > Change in Hedge Effectiveness Method When Hedge Effectiveness Is Assessed on a Quantitative Basis

815-20-35-19 If the entity identifies an improved method of assessing hedge effectiveness ~~and measuring hedge ineffectiveness~~ in accordance with the guidance in paragraph 815-20-25-80 and wants to apply that method prospectively, it shall do both of the following:

- a. Discontinue the existing hedging relationship
- b. Designate the relationship anew using the improved method.

815-20-35-20 The new method of assessing hedge effectiveness shall be applied prospectively and shall also be applied to similar hedges unless the use of a different method for similar hedges is justified. A change in the method of assessing hedge effectiveness by an entity shall not be considered a change in accounting principle as defined in Topic 250.

11. Supersede paragraph 815-20-45-1 and add paragraphs 815-20-45-1A through 45-1D and 815-20-45-3 and the related headings, with a link to transition paragraph 815-20-65-3, as follows:

Other Presentation Matters

> Income Statement Classification

815-20-45-1 Paragraph superseded by Accounting Standards Update No. 2017-12. This Subtopic does not provide guidance on the required income statement classification of the amount of hedge ineffectiveness and the component of a derivative instrument's gain or loss, if any, excluded from the assessment of hedge effectiveness. While the Derivatives and Hedging Topic does not specify whether certain income statement categories are either permitted or appropriate, the other hedging-related Subtopics in this Topic do contain specific disclosure requirements for those items. See Section 815-10-50 and Subtopics 815-25, 815-30, and 815-35. [Content amended and moved to paragraph 815-20-45-1D]

815-20-45-1A For qualifying fair value and cash flow hedges, an entity shall present both of the following in earnings in the same income statement line item that is used to present the earnings effect of the hedged item:

- a. The change in the fair value of the hedging instrument that is included in the assessment of hedge effectiveness
- b. Amounts excluded from the assessment of hedge effectiveness in accordance with paragraphs 815-20-25-83A through 25-83B.

See paragraphs 815-20-55-79W through 55-79AD for related implementation guidance.

815-20-45-1B For cash flow hedges in which the hedged forecasted transaction is probable of not occurring in accordance with paragraph 815-30-40-5, this Subtopic provides no guidance on the required income statement classification of amounts reclassified from accumulated other comprehensive income to earnings.

815-20-45-1C For qualifying net investment hedges, an entity shall present in the same income statement line item that is used to present the earnings effect of the hedged net investment those amounts reclassified from accumulated other comprehensive income to earnings. This Subtopic provides no guidance on the required income statement classification of amounts excluded from the assessment of effectiveness in net investment hedges.

815-20-45-1D This Subtopic does not provide guidance on the required income statement classification of the amount of hedge ineffectiveness and the component of a derivative instrument's gain or loss, if any, excluded from the assessment of hedge effectiveness. While the Derivatives and Hedging Topic does not specify whether certain income statement categories line items are either permitted or appropriate, the other hedging-related Subtopics in this Topic do contain specific disclosure requirements for those items. See Section 815-10-50 and Subtopics

815-25, 815-30, and 815-35. [Content amended as shown and moved from paragraph 815-20-45-1]

> Statement of Cash Flows

815-20-45-2 For guidance on the classification of cash receipts and payments related to hedging activities, see paragraph 230-10-45-27.

> Other Comprehensive Income

815-20-45-3 An entity shall display as a separate classification within other comprehensive income the net gain or loss on **derivative instruments** designated and qualifying as fair value or cash flow hedging instruments that are reported in comprehensive income pursuant to paragraphs 815-20-25-65, 815-20-25-83A, and 815-30-35-3. [Content amended as shown and moved from paragraph 815-30-45-1]

Disclosure

815-20-50-1 See Section 815-10-50 for overall guidance on disclosures about derivative instruments used in hedging activities. For guidance on disclosures about instruments used to mitigate the income statement effect of changes in **fair value** of servicing assets and servicing liabilities, see paragraph 860-50-50-2(b). For guidance on encouraged disclosure of quantitative information about instruments used to manage the risks inherent in servicing assets and servicing liabilities, see paragraph 860-50-50-2.

12. Amend paragraphs 815-20-55-2, 815-20-55-4A, 815-20-55-11 through 55-12, 815-20-55-15, 815-20-55-17, 815-20-55-19, 815-20-55-23, 815-20-55-27 through 55-32 and their related heading, 815-20-55-33A through 55-33B and their related heading, 815-20-55-33E, the heading preceding paragraph 815-20-55-40, 815-20-55-44C, 815-20-55-46, 815-20-55-54 through 55-56 and the related heading, 815-20-55-62, 815-20-55-64, 815-20-55-68 through 55-69, 815-20-55-71, 815-20-55-75, 815-20-55-79A through 79B, 815-20-55-86, 815-20-55-90, 815-20-55-94, 815-20-55-96, 815-20-55-98 through 55-99, 815-20-55-103 through 55-105, 815-20-55-107 through 55-110, 815-20-55-126, 815-20-55-129, 815-20-55-131, 815-20-55-135, 815-20-55-149, 815-20-55-155, 815-20-55-175, 815-20-55-178, 815-20-55-197, 815-20-55-199, the heading preceding paragraph 815-20-55-204, and 815-20-55-211, supersede paragraphs 815-20-55-5 through 55-8 and their related heading, 815-20-55-33C through 55-33D, 815-20-55-33F, 815-20-55-39 and its related heading, 815-20-55-41 through 44-43 and their related heading, and 815-20-55-226 through 55-229 and their related heading, and add paragraphs 815-20-55-14A, 815-20-55-26A through 55-26E and their related headings, 815-20-55-62A, 815-20-55-79C through 55-79AD and their related headings, 815-20-55-80A

and its related heading, and 815-20-55-230 through 55-238 and their related headings, with a link to transition paragraph 815-20-65-3, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

815-20-55-1 This implementation guidance is organized as follows:

- a. Eligibility of hedged items
- b. Eligibility of hedging instruments
- c. Hedge effectiveness.

> > Eligibility of Hedged Items

815-20-55-2 This implementation guidance on eligibility criteria for hedged items is organized as follows:

- a. Subparagraph superseded by Accounting Standards Update No. 2017-12. Embedded options as hedged items
- b. Subparagraph superseded by Accounting Standards Update No. 2017-12. Partial term defines hedged item
- c. Hedged items in fair value hedges only
- d. Hedged items in cash flow hedges only
- e. Hedged items involving foreign exchange risk
- f. Strategic risk ineligible as hedged risk ~~Items specifically ineligible for designation as a hedged item or risk.~~

815-20-55-3 Paragraph not used.

815-20-55-4 Paragraph not used.

> > > Hedged Items in Fair Value Hedges Only

815-20-55-4A This implementation guidance on hedged items in fair value hedges only is organized as follows:

- a. Subparagraph superseded by Accounting Standards Update No. 2017-12. Partial term defines hedged item
- b. Application of the definition of firm commitment
- c. Determining whether risk exposure is shared within a portfolio
- d. Servicing rights as a hedged item.

>>>> Partial Term Defines Hedged Item

815-20-55-5 Paragraph superseded by Accounting Standards Update No. 2017-12. Although paragraph 815-20-25-12(b)(2)(ii) permits identification of a selected portion (rather than proportion) of an asset or liability as the hedged item, in many cases, partial-term hedge **transactions** will fail to meet the offset requirement. For example, the changes in the **fair value** of a two-year interest rate swap cannot be expected to offset the changes in fair value attributable to changes in market interest rates of a four-year fixed-rate debt instrument. For offset to be expected, a principal repayment on the debt (equal to the **notional amount** on the swap) would need to be expected at the end of Year 2.

815-20-55-6 Paragraph superseded by Accounting Standards Update No. 2017-12. Though there is no prohibition against partial-term hedging and other designations of a portion of an asset or liability, paragraph 815-20-25-3(b)(2)(iv) requires an entity to define how the expectation of offsetting changes in fair value or cash flows would be assessed. However, the absence of a prohibition does not necessarily result in qualification for hedge accounting for partial-term or other hedges of part of an asset or a liability. It likely will be difficult to find a **derivative instrument** that will be effective as a **fair value hedge** of selected cash flows.

815-20-55-7 Paragraph superseded by Accounting Standards Update No. 2017-12. For example, an entity may not designate a 3-year interest rate swap with a notional amount equal to the principal amount of its nonamortizing debt as the hedging instrument in a hedge of the exposure to changes in fair value, attributable to changes in the designated **benchmark interest rate**, of the entity's obligation to make interest payments during the first 3 years of its 10-year fixed-rate debt instrument. There would be no basis for expecting that the change in that swap's fair value would be highly effective in offsetting the change in fair value of the liability for only the interest payments to be made during the first three years. Even though under certain circumstances a partial-term fair value hedge can qualify for hedge accounting under this Subtopic, this Subtopic's provisions do not result in reporting a fixed-rate 10-year borrowing as having been effectively converted into a 3-year variable rate and 7-year fixed-rate borrowing as was previously accomplished under **synthetic instrument accounting**, which is now prohibited (see paragraph 815-10-25-4).

815-20-55-8 Paragraph superseded by Accounting Standards Update No. 2017-12. The derivative instrument selected as the hedging instrument in a partial-term fair value hedge must be highly effective at offsetting changes in fair value of the group of selected individual cash flows designated as being hedged. A partial-term fair value hedge of one or more selected contractual cash flows may be achieved under paragraph 815-20-25-12(b)(2)(ii) by designating an appropriate derivative instrument (or instruments) as the hedging instrument. For example, the instrument designated as hedging those individual coupon payments could be

~~described as a derivative instrument that can hedge the changes in the fair value of a zero coupon bond that corresponds to the timing and amount of each individual interest payment.~~

815-20-55-9 Paragraph not used.

> > > Application of the Definition of Firm Commitment

815-20-55-10 This implementation guidance discusses whether certain items meet the definition of a **firm commitment** for purposes of paragraph 815-20-25-12.

815-20-55-11 A firm commitment that represents an asset or liability that a specific accounting standard prohibits recognizing (such as a lessor's noncancellable operating lease or an unrecognized mortgage servicing right) may nevertheless be designated as the hedged item in a {add glossary link}fair value hedge{add glossary link}.

815-20-55-12 A mortgage banker's unrecognized interest rate lock commitment does not qualify as a firm commitment (because as an option it does not obligate both parties) and thus is not eligible for fair value hedge accounting as the hedged item. (However, a mortgage banker's forward sale commitments, which are {add glossary link}derivative instruments{add glossary link} that lock in the prices at which the mortgage loans will be sold to investors, may qualify as hedging instruments in **cash flow hedges** of the forecasted sales of mortgage loans.)

815-20-55-13 A supply contract for which the contract price is fixed only in certain circumstances (such as if the selling price is above an embedded price cap or below an embedded price floor) meets the definition of a firm commitment for purposes of designating the hedged item in a fair value hedge. Provided the embedded price cap or floor is considered clearly and closely related to the host contract and therefore is not accounted for separately under paragraph 815-15-25-1, either party to the supply contract can hedge the fair value exposure arising from the cap or floor.

> > > Determining Whether Risk Exposure Is Shared within a Portfolio

815-20-55-14 This implementation guidance discusses the application of the guidance in paragraph 815-20-25-12(b)(1) that the individual assets or individual liabilities within a portfolio hedged in a fair value hedge shall share the risk exposure for which they are designated as being hedged. If the change in fair value of a hedged portfolio attributable to the hedged risk was 10 percent during a reporting period, the change in the fair values attributable to the hedged risk for each item constituting the portfolio should be expected to be within a fairly narrow range, such as 9 percent to 11 percent. In contrast, an expectation that the change

in fair value attributable to the hedged risk for individual items in the portfolio would range from 7 percent to 13 percent would be inconsistent with the requirement in that paragraph.

815-20-55-14A If both of the following conditions exist, the quantitative test described in paragraph 815-20-55-14 may be performed qualitatively and only at hedge inception:

- a. The hedged item is a closed portfolio of prepayable financial assets or one or more beneficial interests designated in accordance with paragraph 815-20-25-12A.
- b. An entity measures the change in fair value of the hedged item based on the benchmark rate component of the contractual coupon cash flows in accordance with paragraph 815-25-35-13.

Using the benchmark rate component of the contractual coupon cash flows when all assets have the same assumed maturity date and prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate component coupon cash flows.

815-20-55-15 In aggregating loans in a portfolio to be hedged, an entity may choose to consider some of the following characteristics, as appropriate:

- a. Loan type
- b. Loan size
- c. Nature and location of collateral
- d. Interest rate type (fixed or variable)
- e. Coupon interest rate or the benchmark rate component of the contractual coupon cash flows (if fixed)
- f. Scheduled maturity or the assumed maturity if the hedged item is measured in accordance with paragraph 815-25-35-13B
- g. Prepayment history of the loans (if seasoned)
- h. Expected prepayment performance in varying interest rate scenarios.

> > > Servicing Rights as a Hedged Item

815-20-55-16 Paragraph 815-20-25-12(b)(1) provides criteria under which similar assets or similar liabilities may be aggregated and hedged as a portfolio under a fair value hedge, requiring, in part, that the individual assets or individual liabilities share the risk exposure for which they are designated as being hedged. Servicers of financial assets that designate a hedged portfolio by aggregating servicing rights within one or more risk strata used under paragraph 860-50-35-9 would not necessarily comply with the requirement in paragraph 815-20-25-12(b)(1) for portfolios of similar assets because the risk strata under paragraph 860-50-35-9 can be based on any predominant risk characteristic, including date of origination or geographic location.

> > > Hedged Items in Cash Flow Hedges Only

815-20-55-17 This guidance on hedged items in cash flow hedges only is organized as follows:

- a. Exposure to variability in cash flows
- b. Variable price component of a purchase contract as hedged item
- c. Grouping individual transactions
- d. Probability of a **{add glossary link}** forecasted transaction **{add glossary link}**
- e. Specificity of timing of a forecasted transaction
- ee. Determining if a **contractually specified component** exists
- eee. Contractually specified component in a not-yet-existing contract
- f. Forecasted acquisition of a marketable debt security
- g. Stock-appreciation-right obligation as a hedged item
- h. First-payments-received technique in hedging variable nonbenchmark interest payments on a group of loans.

> > > Exposure to Variability in Cash Flows

815-20-55-18 The future sale of an asset or settlement of a liability that exposes an entity (consistent with the criterion in paragraph 815-20-25-15(c)(2)) to the risk of a change in fair value may result in recognizing a gain or loss in earnings when the sale or settlement occurs. Changes in market price could change the amount for which the asset or liability could be sold or settled and, consequently, change the amount of gain or loss recognized. **Forecasted transactions** that expose an entity to cash flow risk have the potential to affect reported earnings because the amount of related revenue or expense may differ depending on the price eventually paid or received. Thus, an entity could designate the forecasted sale of a product at the market price at the date of sale as a hedged transaction because revenue will be recorded at that future sales price.

> > > Variable Price Component of a Purchase Contract as Hedged Item

815-20-55-19 This guidance discusses the implementation of paragraph 815-20-25-15(i). ~~¶ An entity enters into a contract that requires it the buyer to pay a total contract price based on the VWX sugar index on the date of purchase plus a variable basis differential related to transportation costs. \$100 per unit adjusted for a portion of the change in the average market price of sugar, a major ingredient in the item purchased, the buyer~~ The entity may use a derivative instrument whose underlying is the price of sugar or any other underlying for which the derivative would be highly effective in achieving offsetting cash flows in a cash flow hedge of its forecasted purchases under the contract. ~~contract in a hedge of its exposure to changes in the price of sugar. Assume the purchase contract does not meet the definition of a freestanding derivative instrument and does not contain an~~

~~embedded derivative that warrants separate accounting under Subtopic 815-15. Because of the limitations in~~ In accordance with paragraph 815-20-25-15(i), the buyer must ~~entity may~~ designate as the risk being hedged the risk of changes in the cash flows relating to all changes in the purchase price of the items being acquired under the contract. ~~If the only variability in the items' purchase price under this peculiar contract relates to changes in the average market price of sugar, the buyer may use a derivative instrument whose underlying is the price of sugar in a cash flow hedge of its purchases under the contract. The entity also may designate the variability in cash flows attributable to changes in the contractually specified component (VWX sugar index) as the hedged risk. In that case, the entity not only must consider whether the VWX sugar index is explicitly referenced in the purchase agreement but also must ensure that the requirements in paragraph 815-20-25-22A are met. In both scenarios, the entity~~ The buyer must determine that all the criteria for cash flow hedges are satisfied, including that the hedging relationship is highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge.

> > > Grouping Individual Transactions

815-20-55-20 It sometimes will be impractical (perhaps impossible) and not cost-effective for an entity to identify each individual transaction that is being hedged. An example is a group of sales or purchases over a period of time to or from one or more parties. This Subtopic permits an entity to aggregate individual forecasted transactions for hedging purposes in some circumstances. As it does for a hedge of a single forecasted transaction, paragraph 815-20-25-3(d)(1)(vi) requires that an entity identify the hedged transactions with sufficient specificity that it is possible to determine which transactions are hedged transactions when they occur.

815-20-55-21 For example, an entity that expects to sell at least 300,000 units of a particular product in its next fiscal quarter might designate the sales of the first 300,000 units as the hedged transactions. Alternatively, it might designate the first 100,000 sales in each month as the hedged transactions. It could not, however, simply designate any sales of 300,000 units during the quarter as the hedged transaction because it then would be impossible to determine whether the first sales transaction of the quarter was a hedged transaction. Similarly, an entity could not designate the last 300,000 sales of the quarter as the hedged transaction because it would not be possible to determine whether sales early in the quarter were hedged or not.

815-20-55-22 Under the guidance in this Subtopic, a single derivative instrument of appropriate size could be designated as hedging a given amount of aggregated forecasted transactions, such as any of the following:

- a. Forecasted sales of a particular product to numerous customers within a specified time period, such as a month, a quarter, or a year

- b. Forecasted purchases of a particular product from the same or different vendors at different dates within a specified time period
- c. Forecasted interest payments on several variable-rate debt instruments within a specified time period.

815-20-55-23 ~~However~~ At the time of hedge designation only, the transactions in each group must share the risk exposure for which they are being hedged. For example, the interest payments in the group in (c) in the preceding paragraph shall vary with the same index to qualify for hedging with a single derivative instrument.

> > > Probability of a Forecasted Transaction

815-20-55-24 An assessment of the likelihood that a forecasted transaction will take place (see paragraph 815-20-25-15(b)) should not be based solely on management's intent because intent is not verifiable. The transaction's probability should be supported by observable facts and the attendant circumstances. Consideration should be given to the following circumstances in assessing the likelihood that a transaction will occur.

- a. The frequency of similar past transactions
- b. The financial and operational ability of the entity to carry out the transaction
- c. Substantial commitments of resources to a particular activity (for example, a manufacturing facility that can be used in the short run only to process a particular type of commodity)
- d. The extent of loss or disruption of operations that could result if the transaction does not occur
- e. The likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (for example, an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to a common stock offering).

815-20-55-25 Both the length of time until a forecasted transaction is projected to occur and the quantity of the forecasted transaction are considerations in determining probability. Other factors being equal, the more distant a forecasted transaction is or the greater the physical quantity or future value of a forecasted transaction, the less likely it is that the transaction would be considered probable and the stronger the evidence that would be required to support an assertion that it is probable.

> > > Specificity of Timing of a Forecasted Transaction

815-20-55-26 Paragraph 815-20-25-3(d)(1)(vi) requires an entity to identify the hedged forecasted transaction with sufficient specificity to make it clear whether a particular transaction is a hedged transaction when it occurs. Paragraph 815-20-

25-3(d)(1)(i) requires that an entity document the date on or period within which the forecasted transaction is expected to occur. An entity should not be able to choose when to reclassify into earnings a gain or loss on a hedging instrument in accumulated other comprehensive income after the gain or loss has occurred by asserting that the instrument hedges a transaction that has or has not yet occurred. However, this Subtopic does not require that an entity be able to specify at the time of entering into a hedge the date on which the hedged forecasted transaction will occur.

> > > Determining Whether a Contractually Specified Component Exists

815-20-55-26A The definition of a contractually specified component is considered to be met if the component is explicitly referenced in agreements that support the price at which a nonfinancial asset will be purchased or sold. For example, an entity intends to purchase a commodity in the commodity's spot market. If as part of the governing agreements of the transaction or commodities exchange it is noted that prices are based on a pre-defined formula that includes a specific index and a basis, those agreements may be utilized to identify a contractually specified component. After an entity determines that a contractually specified component exists, it must assess whether the variability in cash flows attributable to changes in the contractually specified component may be designated as the hedged risk in accordance with paragraphs 815-20-25-22A through 25-22B.

> > > Contractually Specified Component in a Not-Yet-Existing Contract

815-20-55-26B This guidance discusses the implementation of paragraphs 815-20-25-22B and 815-30-35-37A. Entity A's objective is to hedge the variability in cash flows attributable to changes in a contractually specified component in forecasted purchases of a specified quantity of soybeans on various dates during June 20X1. Entity A has executed contracts to purchase soybeans only through the end of March 20X1. Entity A's contracts to purchase soybeans typically are based on the ABC soybean index price plus a variable basis differential representing transportation costs. Entity A expects that the forecasted purchases during June 20X1 will be based on the ABC soybean index price plus a variable basis differential.

815-20-55-26C On January 1, 20X1, Entity A enters into a forward contract indexed to the ABC soybean index that matures on June 30, 20X1. The forward contract is designated as a hedging instrument in a cash flow hedge in which the hedged item is documented as the forecasted purchases of a specified quantity of soybeans during June 20X1. As of the date of hedge designation, Entity A expects the contractually specified component that will be in the contract once it is executed to be the ABC soybean index. Therefore, in accordance with paragraph 815-20-25-3(d)(1), Entity A documents as the hedged risk the variability in cash flows attributable to changes in the contractually specified ABC soybean index in the

not-yet-existing contract. On January 1, 20X1, Entity A determines that all requirements for cash flow hedge accounting are met and that the requirements of paragraph 815-20-25-22A will be met in the contract once executed in accordance with paragraph 815-20-25-22B. Entity A also will assess whether the criteria in 815-20-25-22A are met when the contract is executed.

815-20-55-26D As part of its normal process of assessing whether it remains probable that the hedged forecasted transactions will occur, on March 31, 20X1, Entity A determines that the forecasted purchases of soybeans in June 20X1 will occur but that the price of the soybeans to be purchased will be based on the XYZ soybean index rather than the ABC soybean index. As of March 31, 20X1, Entity A begins assessing the hedge effectiveness of the hedging relationship on the basis of the changes in cash flows associated with the forecasted purchases of soybeans attributable to variability in the XYZ soybean index. Because the hedged forecasted transactions (that is, purchases of soybeans) are still probable of occurring, Entity A may continue to apply hedge accounting if the hedging instrument (indexed to the ABC soybean index) is highly effective at achieving offsetting cash flows attributable to the revised contractually specified component (the XYZ soybean index). On April 30, 20X1, Entity A enters into a contract to purchase soybeans throughout June 20X1 based on the XYZ soybean index price plus a variable basis differential representing transportation costs.

815-20-55-26E If the hedging instrument is not highly effective at achieving offsetting cash flows attributable to the revised contractually specified component, the hedging relationship must be discontinued. As long as the hedged forecasted transactions (that is, the forecasted purchases of the specified quantity of soybeans) are still probable of occurring, Entity A would reclassify amounts from accumulated other comprehensive income to earnings when the hedged forecasted transaction affects earnings in accordance with paragraphs 815-30-35-38 through 35-41. The reclassified amounts should be presented in the same income statement line item as the earnings effect of the hedged item. Immediate reclassification of amounts from accumulated other comprehensive income to earnings would be required only if it becomes probable that the hedged forecasted transaction (that is, the purchases of the specified quantity of soybeans in June 20X1) will not occur. As discussed in paragraph 815-30-40-5, 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 applying cash flow hedge accounting in the future for similar forecasted transactions.

> > > Forecasted Acquisition of a Marketable Debt Security

815-20-55-27 This discussion provides additional information on the forecasted acquisition of a marketable debt security as a hedged item (see paragraph 815-20-25-16[b]).

815-20-55-28 An entity seeking to reduce the variability of the price at which it will acquire a marketable debt security in the future might use a forward contract to fix the price today, ~~or a warrant or purchased option to lock in a ceiling on the price it will eventually pay.~~

815-20-55-29 With a forward contract, the typical settlement is the delivery of the marketable debt security at a later date at the pre-fixed price.

815-20-55-30 With a purchased option (~~including a warrant~~), the typical settlement might be the delivery of the marketable debt security at the ceiling price, or the holder may allow the purchased option to expire unexercised.

815-20-55-31 Therefore, to qualify for cash flow hedge accounting in this circumstance, the entity shall be able to establish that it is probable that it will acquire the marketable debt security by any of the following means:

- a. Exercising the option designated as the hedging instrument if it is in the money
- b. Purchasing the security in the marketplace at its prevailing market price if the option is out of the money.

815-20-55-32 If the entity expects to acquire the marketable debt security only by exercising the option and only if the option were in the money, a cash flow hedging relationship typically would not be designated because acquisition of the security is contingent and thus would not be considered probable.

> > > Stock-Appreciation-Right Obligation as a Hedged Item

815-20-55-33 This guidance addresses the application of the criteria in Section 815-20-25 to an unrecognized, nonvested **stock appreciation right** as a hedged item. An unrecognized, nonvested stock appreciation right relates to the portion of the stock appreciation right liability that has not yet been accrued. It does not refer to future fair value changes in the recognized liability for the vested portion of the stock appreciation right. To the extent that vesting of stock appreciation rights is probable, a purchased call option indexed to an entity's own stock that is recorded as an asset and accounted for as a derivative instrument may be designated as the hedging instrument in a hedge of cash flow variability of expected future obligations associated with unrecognized, nonvested stock appreciation rights if the option is classified as an asset in the entity's financial statements and the option is a derivative instrument subject to Subtopic 815-10. Presumably, if using this strategy, hedge effectiveness typically would be assessed based on changes in the entire value of the purchased call option, rather than just the intrinsic value of the option because the fair value of the unrecognized, nonvested stock appreciation rights likewise consists of a time value portion and an intrinsic value portion. Because an unrecognized, nonvested stock appreciation right results in

exposure to cash flow variability of expected future obligations that affects reported earnings, it is eligible to be designated as being hedged. A stock appreciation right that is recognized as a liability may not be designated as being hedged in a cash flow hedge because the hedged cash flow variability in a recognized stock appreciation right relates to a liability that is remeasured with changes in fair value reported currently in earnings. The hedge of exposure to cash flow variability in an unrecognized, nonvested stock appreciation right could be expected to be highly effective. The entity's stock price is the underlying for both the unrecognized, nonvested stock appreciation right and the option on the entity's own stock. Changes in fair value of the purchased call option on the entity's own stock would be recorded in other comprehensive income consistent with paragraph 815-30-35-3. As required by paragraphs 815-30-35-38 through 35-41, the amount in other comprehensive income would be reclassified into earnings concurrent with the recognition in earnings of compensation cost on the stock appreciation right that relates to those fair value changes that occurred during the hedge period over the requisite service period.

> > > First-Payments-Received Technique in Hedging Variable Nonbenchmark Interest Payments on a Group of Loans

815-20-55-33A ~~This implementation guidance discusses how a~~ A first-payments-received technique for identifying the hedged forecasted transactions (that is, the hedged interest payments) may be used in a cash flow hedge of interest rate risk associated with the variable prime rate based or other variable non benchmark-rate based interest payments for a rolling portfolio of prepayable interest-bearing loans (or other interest-bearing financial assets), provided all other conditions for a cash flow hedge have been met. Such a technique involves identifying the hedged forecasted transactions in a cash flow hedge as the first interest payments based on the specific nonbenchmark contractually specified interest rate received by an entity during each recurring period of a specified length and beginning date for the period covered by the hedging instrument. Example 4, Case A (see paragraphs 815-20-55-91 through 55-96) illustrates this technique.

815-20-55-33B Similarly, a comparable first-payments-made technique may be used to identify the hedged forecasted transactions in a cash flow hedge of the ~~variable non benchmark-rate based~~ contractually specified rate-based interest payments for a group of the reporting entity's financial liabilities, provided all other conditions for a cash flow hedge have been met.

815-20-55-33C ~~Paragraph superseded by Accounting Standards Update No. 2017-12. In cash flow hedging relationships involving variable nonbenchmark rate-based interest payments, the entity is limited to designating the hedged risk as the risk of overall changes in those hedged cash flows (including the risk of decreases in cash flows attributable to credit default) because paragraph 815-20-25-43(d)(3) prohibits an entity from designating interest rate risk as the hedged risk if the cash~~

flows of the hedged transaction are explicitly based on an index different from the benchmark interest rates permitted. Consequently, the shortcut method described in paragraph 815-20-25-102 cannot be used because that method is limited to hedges of interest rate risk.

815-20-55-33D Paragraph superseded by Accounting Standards Update No. 2017-12. The use of the first payments received technique as described in the paragraph 815-20-55-33A is permitted by this Subtopic as an exception even though that technique excludes the variable interest payments that are contractually due but not paid by the debtor from being hedged transactions, thereby excluding some of the risk of decreases in interest payment inflows attributable to credit default. This implementation guidance related to applying the first payments received technique to the variable nonbenchmark rate based interest payments for a rolling portfolio of interest-bearing financial assets shall not be applied by analogy to other circumstances.

815-20-55-33E This implementation guidance regarding use of a first-cash-flows technique may also may be applied to a cash flow hedging relationship in which the hedging instrument is a basis swap as discussed beginning in paragraph 815-20-25-50. However, use of that technique for those basis-swap hedging relationships may not be common ~~since~~ because that paragraph limits designating a basis swap as the hedging instrument to cash flow hedges of the contractually specified interest payments of only recognized financial assets and liabilities existing at the inception of the hedge, whereas the first-cash-flows technique is typically applied to the contractually specified interest payments for rolling portfolios whose composition of financial assets changes over the period of the hedge.

815-20-55-33F Paragraph superseded by Accounting Standards Update No. 2017-12. Entities that choose to use the first payments received technique are still required by this Subtopic to assess the effectiveness of the cash flow hedging relationship and to recognize ineffectiveness in earnings attributable to overhedges. For example, if the hedged interest payments on a variable rate bank loan are based on a bank's own prime rate but the hedging interest rate swap is based on the prime rate specified in the Federal Reserve Statistical Release H-15, and the hedging relationship is not expected to be highly effective in achieving offsetting of the overall changes in designated cash flows (pursuant to either prospective considerations or retrospective evaluations), then hedge accounting would not be permitted. In contrast, if the hedging relationship is expected to be highly effective (and all hedge accounting criteria have been met), any difference between the changes in each of those two prime rates (for the period between assessment dates) could cause the hedging relationship to have some ineffectiveness in achieving offsetting cash flows. However, that ineffectiveness would be recognized immediately in earnings only if it resulted from an overhedge pursuant to Section 815-30-35. Another potential source of ineffectiveness is margin variability (that is, changes in the spread over the nonbenchmark rate)

~~attributable to the replacement loans being added to (and existing loans removed from) the rolling portfolio of interest bearing loans. Margin variability would cause changes over time in the hedged cash flows (which are the interest payments received first chronologically), with no offset in the cash flows of the hedging derivative. In determining which interest payments are received first and thus are the hedged transactions, interest payments that are received concurrently may not be arbitrarily sorted to minimize or achieve a desired amount of ineffectiveness in the hedging relationship.~~

> > Hedged Items Involving Foreign Exchange Risk

815-20-55-34 This implementation guidance on hedged items involving **foreign exchange risk** is organized as follows:

- a. Foreign-currency-denominated interest payments
- b. Foreign-currency-denominated debt instrument as both hedging instrument and hedged item.

> > > Foreign-Currency-Denominated Interest Payments

815-20-55-35 An entity may not treat foreign-currency-denominated fixed-rate interest coupon payments arising from an issuance of foreign-currency-denominated fixed-rate debt as an unrecognized firm commitment that may be designated as a hedged item in a foreign currency fair value hedge. (See paragraph 815-20-25-23.) The foreign-currency exposure of the future interest payments would not meet this Subtopic's definition of an unrecognized firm commitment because the obligation is recognized on the balance sheet—that is, the carrying amount of the foreign-currency-denominated fixed-rate debt incorporates the entity's obligation to make those future interest payments as well as the repayment of principal. However, those fixed-rate interest payments could be designated as the hedged transaction in a cash flow hedge.

815-20-55-36 Those fixed-rate interest payments might arise as follows. An entity whose functional currency is the U.S. dollar issues fixed-rate debt denominated in a foreign currency. The debt has a fixed interest coupon that is payable semiannually in that foreign currency. The entity wishes to lock in, in U.S. dollar functional currency terms, the future interest expense that will result from the debt and enters into a derivative instrument to hedge the foreign currency risk of the fixed foreign-currency-denominated interest coupon payments. For example, the entity may enter into a foreign currency swap to receive an amount of the foreign currency required to satisfy the interest coupon obligation in exchange for U.S. dollars at each coupon date, or, alternatively, it may enter into a strip of foreign currency forward contracts that provide for receipt of an amount of foreign currency required to satisfy the interest coupon obligation in exchange for the payment of U.S. dollars at each coupon date.

815-20-55-37 This guidance also applies to dual-currency bonds that provide for repayment of principal in the functional currency and periodic fixed-rate interest payments denominated in a foreign currency. Subtopic 830-20 applies to dual-currency bonds and requires the present value of the interest payments denominated in a foreign currency to be remeasured and the transaction gain or loss recognized in earnings. Thus, those fixed-rate interest payments on a dual-currency bond could be designated as the hedged transaction in a cash flow hedge of foreign exchange risk.

> > > Foreign-Currency-Denominated Debt Instrument as both Hedging Instrument and Hedged Item

815-20-55-38 A foreign-currency-denominated debt instrument that is designated as the hedging instrument in a net investment hedge may also be designated as the hedged item in a fair value hedge of **interest rate risk**. The two hedging relationships address separate risk types that are permitted to be hedged individually under this Subtopic. Example 10 (see paragraph 815-20-55-127) illustrates this circumstance.

>>> ~~Items Specifically Ineligible for Designation as a Hedged Item or Risk~~

815-20-55-39 Paragraph superseded by Accounting Standards Update No. 2017-12. This implementation guidance on items specifically ineligible for designation as a hedged item or risk is organized as follows:

- a. ~~Strategic risk ineligible as hedged risk~~
- b. ~~Auction rate notes ineligible as hedged item for interest rate risk.~~

>>>> >>> Strategic Risk Ineligible as Hedged Risk

815-20-55-40 The offset criterion in paragraph 815-20-25-75 precludes hedge accounting for certain risk management techniques, such as hedges of strategic risk. For example, a U.S. manufacturer, with no export business, that designates a forward contract to buy U.S. dollars (USD) for Japanese yen (JPY) as a hedge of its USD sales would fail the requirement that the cash flows of the derivative instrument are expected to be highly effective in achieving offsetting cash flows on the hedged transaction. A weakened JPY might allow a competitor to sell goods imported from Japan more cheaply, undercutting the domestic manufacturer's prices and reducing its sales volume and revenues. However, it would be difficult for the U.S. manufacturer to expect a high degree of offset between a decline in U.S. sales revenue due to increased competition and cash inflows on a foreign currency derivative instrument. Any relationship between the exposure and the hedging derivative typically would be quite indirect, would depend on price elasticities, and would be only one of many factors influencing future results. In

addition, the risk that a desired or expected number of transactions will not occur, that is, the potential absence of a transaction, is not a hedgeable risk for accounting purposes.

>>> Auction Rate Notes Ineligible as Hedged Item for Interest Rate Risk

815-20-55-41 Paragraph superseded by Accounting Standards Update No. 2017-12. This implementation guidance discusses further the application of paragraph 815-20-25-43(d)(3).

815-20-55-42 Paragraph superseded by Accounting Standards Update No. 2017-12. A variable rate financial asset or liability that is reset through an auction process is not based on a benchmark interest rate. Although the interest rate may be described as a designated benchmark interest rate plus or minus an adjustment specified by the bidder, the clearing rate is effectively established by a bidding process that does not provide for transparent separation of interest rate risk and credit risk. Thus, the designated risk being hedged in an auction rate note cannot be interest rate risk.

815-20-55-43 Paragraph superseded by Accounting Standards Update No. 2017-12. In a cash flow hedge of a variable rate financial asset or liability for which the interest rate is not based solely on an index, including situations in which an interest rate is reset through an auction process, the designated risk being hedged can be the risk of overall changes in the hedged cash flows related to the variable rate financial asset or liability provided all of the other cash flow hedging criteria in this Subtopic are met.

> > Eligibility of Hedging Instruments

815-20-55-44 This implementation guidance on eligibility of hedging instruments is organized as follows:

- a. Contingent designation of a hedging instrument
- b. No hedge accounting for covered call strategies
- c. Mixed-attribute derivative commodity contracts as cash flow hedging instruments
- d. Subparagraph superseded by Accounting Standards Update No. 2016-19.
- e. Synthetic foreign currency borrowing ineligible as a hedging instrument.

> > > Contingent Designation of a Hedging Instrument

815-20-55-44A A contract that meets the definition of a derivative instrument after acquisition by an entity may be designated as a hedging instrument.

815-20-55-44B During the period in which the contract does not meet the definition of a derivative instrument, that contract cannot be designated as the hedging instrument in any hedging relationship. (However, the contract could potentially be the hedged item in a fair value hedge or its cash flows could potentially be the hedged transactions in a cash flow hedge.)

815-20-55-44C The contingent designation of a hedging relationship in which the hedging instrument is not currently a derivative instrument but may become one cannot justify the application of hedge accounting to fair value changes occurring before inception of the hedge; the inception of that hedging relationship would be the date on which the contract meets the definition of a derivative instrument. If an entity had anticipated that a contract that was not a derivative instrument at inception might later meet the definition of a derivative instrument and has made a contingent designation of an all-in-one hedging relationship to be effective upon the date that the contract meets the definition of a derivative instrument, only the changes in the fair value of the new derivative instrument occurring after the date the contract became a derivative instrument would be recognized in other comprehensive income pursuant to paragraph 815-30-35-3(b).

> > > No Hedge Accounting for Covered Call Strategies

815-20-55-45 This Subtopic does not permit hedge accounting for covered call strategies (strategies in which an entity writes an option on an asset that it owns) unless that asset is a call option that is embedded in another instrument. In a covered call strategy, any loss on the written option will be covered by the gain on the owned asset. A covered call strategy will not qualify for hedge accounting because the risk profile of the combined position is asymmetrical (the exposure to losses is greater than the potential for gains). In contrast, the risk profile of the asset alone is symmetrical or better (the potential for gains is at least as great as the exposure to losses). The symmetry requirement for hedges with written options precludes a written option that is used to sell a portion of the gain potential on an asset or liability from being eligible for hedge accounting.

> > > Mixed-Attribute Derivative Commodity Contracts as Cash Flow Hedging Instruments

815-20-55-46 Commodity contracts commonly have features of both fixed-price contracts and variable-price contracts, such as an agreement to purchase a commodity in the future at the prevailing market index price at that future date plus or minus a fixed basis differential set at the inception of the contract. Assume an example mixed-attribute contract has the characteristics of {add glossary link}notional amount{add glossary link}, underlying, and no initial net investment and the commodity to be delivered is **readily convertible to cash** pursuant to the guidance beginning in paragraph 815-10-15-119.

815-20-55-47 Because that mixed-attribute contract is a derivative instrument and has an underlying related solely to changes in the basis differential, that contract (as a derivative instrument) would generally not be sufficiently effective if designated as the sole hedging instrument in a cash flow hedge of the anticipated purchase or sale of the commodity—a forecasted transaction whose variability in cash flows is based on changes in both the basis differential and the base commodity price. Because its underlying relates solely to changes in the basis differential, the mixed-attribute contract would essentially be hedging only a portion of the variability in cash flows. The entity is not permitted to designate a cash flow hedging relationship as hedging only the change in cash flows attributable to changes in the basis differential. For an entity to be able to conclude that such a hedging relationship is expected to be highly effective in achieving offsetting cash flows, the entity would need to consider the likelihood of changes in the base commodity price as remote or insignificant to the variability in hedged cash flows (for the total purchase or sales price). However, the mixed-attribute contract may be combined with another derivative instrument whose underlying is the base commodity price, with the combination of those derivative instruments designated as the hedging instrument in a cash flow hedge of the overall variability of cash flows for the anticipated purchase or sale of the commodity. Such a combination would address the risk of changes in both the basis differential and the base commodity price.

815-20-55-48 Paragraph not used.

> > > Synthetic Foreign Currency Borrowing Ineligible as a Hedging Instrument

815-20-55-49 A debt instrument denominated in the investor's functional currency and a cross-currency interest rate swap cannot be accounted for as synthetically created foreign-currency-denominated debt to be designated as a hedge of the entity's net investment in a foreign operation.

815-20-55-50 For example, a parent entity that has the U.S. dollar (USD) as its functional and reporting currency has a net investment in a Japanese yen- (JPY-) functional-currency subsidiary. The parent borrows in euros (EUR) on a fixed-rate basis and simultaneously enters into a receive-EUR, pay-Japanese yen currency swap (for all interest and principal payments) to synthetically convert the borrowing into a yen-denominated borrowing. The parent entity cannot designate the EUR-denominated borrowing and the currency swap in combination as a hedging instrument for its net investment in the JPY-functional-currency subsidiary.

815-20-55-51 An approach that would involve measuring a derivative instrument and a cash instrument as a single unit at the current **spot rate** (which is used in the translation of the hedged net investment) violates the requirements of Subtopic 830-20 for translation of foreign-currency-denominated borrowings at the spot rate

relevant to the currency of the borrowing. It also violates the requirements of Subtopic 815-10 for measurement of all derivative instruments at fair value. Accordingly, combining the EUR denominated borrowing and the currency swap for designation as a single hedging instrument—a JPY-denominated borrowing—in a net investment hedge is not permitted.

815-20-55-52 In contrast, an entity could designate a foreign currency derivative instrument and a foreign-currency-denominated cash instrument individually as hedging different portions of its net investment in a foreign operation provided the derivative instrument and the cash instrument each individually qualified as a hedging instrument.

815-20-55-53 For example, a JPY-USD forward contract and a JPY-denominated cash instrument could each be designated as the hedging instrument in a hedge of different portions of the net investment in a JPY-functional-currency subsidiary (that is, two separate hedging relationships would be designated).

> > Hedge Effectiveness

815-20-55-54 This implementation guidance on hedge effectiveness is organized as follows:

- a. Changes in quantitative assessment methods
- b. Components of option time value
- c. Effect of interest rate indexes
- d. Prohibition of preset hedge coverage ratios
- e. Methodologies to assess effectiveness of fair value and cash flow hedges
- f. Applicability of the shortcut method
- g. Application of the prepayable criterion under the shortcut method
- h. Determining whether a mirror-image call provision exists in application of the shortcut method
- i. Simplified hedge accounting approach.
- j. Timing of initial quantitative prospective effectiveness assessment
- k. Eligibility of hedging relationships for subsequent qualitative effectiveness assessments
- l. Change in facts and circumstances in qualitative effectiveness assessments
- m. Income statement presentation of hedging instruments.

> > > Changes in Quantitative Assessment Methods

815-20-55-55 Examples If an entity elects to or is required to assess hedge effectiveness on a quantitative basis after the initial quantitative assessment of hedge effectiveness, examples of changes in the types of methods an entity may

use in assessing hedge effectiveness (see paragraph 815-20-35-20) could include the following:

- a. A change from the dollar-offset method to the use of regression analysis or vice versa
- b. A change between any one of the three methods discussed beginning in paragraph 815-30-35-10 (for example, a change from the change in variable cash flows method to either the hypothetical derivative method or the change in fair value method)
- c. A change from excluding certain components of a derivative instrument gain or loss to including such components or vice versa (for example, a change from ~~assessing~~ ~~measuring~~ effectiveness based on changes in intrinsic value to the entire change in an option's fair value)
- d. A change from assessing hedge effectiveness on a period-by-period basis to a cumulative basis or vice versa.

815-20-55-56 This Subtopic permits a hedging relationship to be dedesignated (that is, discontinued) at any time. (See paragraphs 815-25-40-1(c) and 815-30-40-1(c).) If an entity wishes to change any of the critical terms of the hedging relationship (including the method designated for use in assessing hedge effectiveness), as documented at inception, the mechanism provided in this Subtopic to accomplish that change is the dedesignation of the original hedging relationship and the designation of a new hedging relationship that incorporates the desired changes. However, as discussed in paragraph 815-30-35-37A, a change to the hedged risk in a cash flow hedge of a forecasted transaction does not result in an automatic dedesignation of the hedging relationship if the hedging instrument continues to be highly effective at achieving offsetting cash flows associated with the hedged item attributable to the revised hedged risk. The dedesignation of an original hedging relationship and the designation of a new hedging relationship represents the application of this Subtopic and is not a change in accounting principle under Topic 250, even though the new hedging relationship may differ from the original hedging relationship only with respect to the method designated for use in assessing the hedge effectiveness of that hedging relationship. Although paragraph 815-20-35-19 refers to discontinuing an existing hedging relationship and then designating and documenting a new hedging relationship using an improved method for assessing effectiveness, that reference was not meant to imply that the perceived improved method had to be justified as a preferable method of applying an accounting principle under Topic 250.

815-20-55-56A For the purposes of applying the guidance in paragraph 815-20-55-56, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a change in a critical term of the hedging relationship.

> > > Components of Option Time Value

815-20-55-57 This guidance discusses implementation of paragraph 815-20-25-82.

815-20-55-58 Some entities may wish to assess hedge effectiveness based on the change in an option's value excluding a certain aspect of the change in the **option's time value**. For example, some entities may wish to exclude the change in time value attributable to the passage of time (theta) from the assessment of hedge effectiveness, while assessing hedge effectiveness based on the remaining components of changes in an option's value. As an illustration, if out-of-the-money options are designated as hedging instruments, changes in value of the option are primarily driven by the change, if any, in the value of the underlying (delta). If the price of the underlying asset changes, in effective hedging strategies involving out-of-the-money options, the hedge gain or loss due to delta would offset the change in value of the hedged item; however, if the price of the underlying does not change, there is no change in fair value attributable to changes in delta. In that case, the only change in the option's value is attributable to the passage of time (theta), or to changes in other market variables such as volatilities or interest rates. Accordingly, for those hedging relationships to qualify for hedge accounting, an entity may need to exclude the change in value attributable to theta from the assessment of hedge effectiveness.

815-20-55-59 Other entities may wish to exclude changes in time value attributable to certain market variables—volatility (vega) or interest rates (rho)—from the assessment of hedge effectiveness. An entity may wish to exclude changes in time value attributable to volatility (vega) from the assessment of hedge effectiveness because the fair value measurement of the hedged item does not incorporate a measure of implied volatility.

815-20-55-60 Similarly, an entity may seek to exclude changes in time value attributable to interest rates (rho) from the assessment of hedge effectiveness. For example, in a foreign currency hedge involving a country in which interest rates are volatile, a substantial portion of the change in value of the option may be attributable to fluctuations in those interest rates, while the fair value of the hedged item is not affected correspondingly. Accordingly, for these hedging relationships to qualify for hedge accounting, an entity may need to exclude the change in value attributable to the relevant market variable from the assessment of hedge effectiveness.

815-20-55-61 In summary, the exclusion of a certain aspect of the change in an option's time value from the assessment of hedge effectiveness is driven by the fact that, in certain circumstances, the measurement of changes in fair value of the hedged item or changes in the cash flows of the hedged transaction does not

depend on or incorporate that aspect. Option valuation models are capable of isolating the various aspects of changes in an option's time value.

> > > Effect of Interest Rate Indexes

815-20-55-62 The effectiveness of a cash flow hedge of the variability in interest payments of a variable-rate financial asset or liability, either existing or forecasted, is affected by the contractually specified interest rate index on which the variability is based and the extent to which the hedging instrument provides offset. ~~Changes in credit sector spreads embodied within the interest rate index on which the variability is based do not affect the assessment and measurement of hedge effectiveness if both the cash flows on the hedging instrument and the hedged cash flows of the existing financial asset or liability or the variable rate financial asset or liability that is forecasted to be acquired or issued are based on the same index. However, if~~ If the cash flows on the hedging instrument and the contractually specified interest rate of the hedged cash flows of the existing financial asset or liability or the contractually specified interest rate of the variable-rate financial asset or liability that is forecasted to be acquired or issued are based on different indexes, the basis difference between those indexes would affect the assessment and measurement of hedge effectiveness. ~~Paragraph 815-20-25-43(d)(3) states that in a cash flow hedge of a variable rate financial asset or liability, either existing or forecasted, the designated hedged risk cannot be the risk of changes in its cash flows attributable to changes in the specifically identified benchmark interest rate if the cash flows of the hedged transaction are explicitly based on a different index.~~

815-20-55-62A An entity may designate as the hedged risk only the change in cash flows of the contractually specified interest rate, not an implied rate embedded in the interest rate. For example, if an entity issues variable-rate debt based on its own prime rate, it cannot designate the change in cash flows of the Fed Funds Target rate or the Wall Street Journal prime rate as the hedged risk.

> > > Prohibition of Preset Hedge Coverage Ratios

815-20-55-63 Subtopic 860-50 requires that if an entity subsequently measures servicing assets and servicing liabilities using the amortization method, any impairment of servicing assets, which is the amount by which the carrying amount of the servicing assets for an individual stratum exceeds their fair value, be recognized in current earnings. However, an increase in the fair value above the carrying amount of servicing assets for an individual stratum may not be recognized in current earnings.

815-20-55-64 Entities that service certain types of financial assets may wish to designate as the hedged item in a fair value hedge a prespecified percentage of the total change in fair value of those servicing rights (attributable to the hedged risk) that varies based on changes in a specified independent variable. Because

the prespecified percentage for each specified independent variable can be presented in a rectangular array, that method of determining the hedged item retroactively based on the actual independent variable is sometimes referred to as the matrix method. Under that approach, at the end of the hedge assessment period, the entity would determine the hedged item and assess ~~measure~~ hedge effectiveness ~~ineffectiveness~~ by determining retrospectively which hedge coverage ratio would be applied to the servicing right asset to identify the hedged item for that period. That approach is in contrast to designating the hedged item at the inception of the hedge by specifying a single percentage of that recognized servicing right asset as the hedged item.

815-20-55-65 In a fair value hedge of a portion of a recognized servicing right asset subsequently measured using the amortization method and its related impairment analysis, an entity may not designate the hedged item at the inception of the hedge by initially specifying a series of possible percentages of the servicing right asset (that is, preset hedge coverage ratios) and then determining at the end of the assessment period what specific percentage of the servicing right asset is the actual hedged item for that period based on the change in a specified independent variable during that period. Such a matrix method would not be a valid application of the provisions of this Subtopic.

815-20-55-66 Paragraph 815-20-25-12(b)(2)(i) precludes an entity from expressing the hedged item as multiple percentages of a recognized asset or liability and then retroactively determining the hedged item based on an independent matrix of those multiple percentages and the actual scenario that occurred during the period for which hedge effectiveness is being assessed.

815-20-55-67 There is a limited exception under paragraph 815-20-25-10 in which a collar that is comprised of one purchased option and one written option that have different notional amounts is designated as the hedging instrument, and the hedged item is specified as two different proportions of the same asset based on the upper and lower rate or price range of the asset referenced in those two options.

> > > Methodologies to Assess Effectiveness of Fair Value and Cash Flow Hedges

815-20-55-68 As discussed in paragraph 815-20-25-80, if an entity assesses ~~assesses~~ hedge effectiveness on a quantitative basis and elects at the inception of a hedging relationship to utilize a regression analysis approach for prospective considerations of assessing effectiveness and the dollar-offset method to perform retrospective evaluations of assessing effectiveness, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Thus, in its retrospective evaluation, an entity might conclude that, under a dollar-offset approach, a designated hedging relationship does not qualify

for hedge accounting for the period just ended, but that the hedging relationship may continue because, under a regression analysis approach, there is an expectation that the relationship will be highly effective in achieving offsetting changes in fair value or cash flows in future periods. In its retrospective evaluation, if that entity concludes that, under a dollar-offset approach, the hedging relationship has not been highly effective in having achieved offsetting changes in fair value or cash flows, hedge accounting may not be applied in the current period. Whenever a hedging relationship fails to qualify for hedge accounting in a certain assessment period, the overall change in fair value of the derivative instrument for that current period is recognized in earnings (not reported in other comprehensive income for a cash flow hedge) and the change in fair value of the hedged item would not be recognized in earnings for that period (for a fair value hedge).

815-20-55-69 As discussed in paragraph 815-20-35-3(b), if an entity assesses hedge effectiveness on a quantitative basis and elects at the inception of a hedging relationship to utilize a regression analysis (or other statistical analysis) approach for either prospective considerations or retrospective evaluations of assessing effectiveness, then that entity shall periodically update its regression analysis (or other statistical analysis). ~~For example, if there is significant ineffectiveness measured and recognized in earnings for a hedging relationship, which is calculated each assessment period, the regression analysis should be rerun to determine whether the expectation of high effectiveness is still valid.~~ As long as an entity reruns its regression analysis and determines that the hedging relationship is still expected to be highly effective, then it can continue to apply hedge accounting without interruption.

815-20-55-70 The application of a regression or other statistical analysis approach to assessing effectiveness is complex. Those methodologies require appropriate interpretation and understanding of the statistical inferences.

> > > **Applicability of the Shortcut Method**

815-20-55-71 Given the conditions in paragraph 815-20-25-104, the shortcut method cannot be applied, for example, to any of the following hedging relationships:

- a. Those hedging interest rate risk that involve hedging instruments other than interest rate swaps.
- b. ~~Those~~ For fair value hedges, those that involve hedged risks other than the risk of changes in fair value ~~(or cash flows)~~ attributable to changes in the designated **{add glossary link}** benchmark interest rate **{add glossary link}**. ~~For example, cash flow hedging relationships in which the cash flows of the hedged item and the hedging instrument are based on the same index but that index is not the benchmark interest rate.~~
- bb. For cash flow hedges, those that involve hedging relationships in which the contractually specified interest rate of a recognized interest-bearing

asset or liability does not match the interest rate index of the variable leg of the interest rate swap.

- c. Those that do not involve a recognized interest-bearing asset or liability.

815-20-55-72 Based on (c) in the preceding paragraph, the shortcut method cannot be applied in a cash flow hedge of a forecasted transaction, even if an entity determines that all critical terms of the hedging instrument and the hedged forecasted transaction are matched.

815-20-55-73 Paragraph superseded by Accounting Standards Update No. 2016-02.

> > > Application of the Prepayable Criterion under the Shortcut Method

815-20-55-74 This implementation guidance discusses the application of the **prepayable** criterion in paragraph 815-20-25-104(e) and related guidance beginning in paragraph 815-20-25-112.

815-20-55-75 A debt instrument may contain various terms and provisions that permit either the debtor or the creditor to cause prepayment of the debt (that is, cause the payment of principal before the scheduled payment dates), including the terms in the following illustrative instruments:

- a. Illustrative debt instrument 1. Some fixed-rate debt instruments include a typical call option that permits the debt instrument to be called for prepayment by the debtor at a fixed amount, for example, at par or at a specified premium over par. In some instruments, the prepayment amount varies based on when the call option is exercised. Fixed-rate debt instruments that provide the borrower with the option to prepay at a fixed amount are considered prepayable under paragraph 815-20-25-104(e), because those contracts permit settlement at an amount that is potentially below the contract's fair value (absent the effect of the call provision) as of the date of settlement. Such clauses can be exercised based on an economic advantage related to changes in the designated benchmark interest rate.
- b. Illustrative debt instrument 2. Some debt instruments include contingent acceleration clauses that permit the lender to accelerate the maturity of an outstanding note only if a specified event related to the debtor's credit deterioration or other change in the debtor's credit risk occurs (for example, the debtor's failure to make timely payment, thus making it delinquent; its failure to meet specific covenant ratios; its disposition of specific significant assets, such as a factory; a declaration of cross-default; or a restructuring by the debtor). A common example is a clause in a mortgage note secured by certain property that permits the lender to accelerate the maturity of the note if the borrower sells the property. Debt instruments that include contingent acceleration clauses that permit the

lender to accelerate the maturity of an outstanding note only upon the occurrence of a specified event related to the debtor's credit deterioration or other changes in the debtor's credit risk are not considered prepayable under paragraph 815-20-25-104(e).

- c. Illustrative debt instrument 3. Some fixed-rate debt instruments include a call option that permits the debtor to repurchase the debt instrument from the creditor at an amount equal to its then fair value. Fixed-rate debt instruments that provide the debtor with the option to repurchase from the creditor the debt at an amount equal to the then fair value of the contract are not considered prepayable under paragraph 815-20-25-104(e), because that right would have a fair value of zero at all times. Such clauses, which provide the debtor with the discretionary opportunity to settle its obligation before maturity, are not exercised based on an economic advantage related to changes in the designated benchmark interest rate because the repurchases are done at fair value.
- d. Illustrative debt instrument 4. Some fixed-rate debt instruments, typically issued in private markets, include a **make-whole provision**. A make-whole provision differs from a typical call option, which enables the issuer to benefit by prepaying the debt if market interest rates decline. In a declining interest rate market, the settlement amount of a typical call option is less than what the fair value of the debt would have been absent the call option. In contrast, a make-whole provision involves settlement at a variable amount typically determined by discounting the debt's remaining contractual cash flows at a specified small spread over the current Treasury rate. That calculation results in a settlement amount significantly above the debt's current fair value based on the issuer's current spread over the current Treasury rate. The make-whole provision contains a premium settlement amount to penalize the debtor for prepaying the debt and to compensate the investor (that is, to approximately make the investor whole) for its being forced to recognize a taxable gain on the settlement of the debt investment. In some debt instruments, the prepayment option under a make-whole provision will not be exercisable during an initial lock-out period. (For example, Private Entity A borrows from Insurance Entity B under a 10-year loan with fixed periodic coupon payments. The spread over the Treasury rate for Entity A at issuance of the debt is 275 basis points. The loan agreement contains a make-whole provision that if Entity A prepays the debt, it will pay Insurance Entity B an amount equal to all the future contractual cash flows discounted at the current Treasury rate plus 50 basis points.) Fixed-rate debt instruments that include a make-whole provision (as previously described) are not considered prepayable under paragraph 815-20-25-104(e), because it involves settlement of the entire contract by the debtor before its stated maturity at an amount greater than (rather than an amount less than) the then fair value of the contract.
- e. Illustrative debt instrument 5. Some variable-rate debt instruments include a call option that permits the debtor to repurchase the debt

instrument from the creditor at each interest reset date at an amount equal to par. Although illustrative debt instrument 5, a variable-rate debt instrument, does have a fair value exposure between the date of a change in the contractually specified benchmark interest rate and the reset date, a swap would not be an appropriate hedging instrument to hedge that fair value exposure. Thus, a fair value hedge of illustrative debt instrument 5 could not qualify for the shortcut method discussed in paragraph 815-20-25-102, which requires the hedging instrument to be an interest rate swap. In cash flow hedges, if the reset provisions always result in the instrument's par amount being equal to its fair value at a reset date, then an option for the debtor to prepay the variable-rate debt instrument at par at that reset date would not be considered prepayable under paragraph 815-20-25-104(e). However, if the reset provisions can result in the instrument's par amount not being equal to its fair value at those reset dates, then an option for the debtor to prepay the variable-rate debt instrument at par at a reset date would be considered prepayable under that paragraph. (Because the reset provisions typically do not adjust the variable interest rate for changes in credit sector spreads and changes in the debtor's creditworthiness, the variable-rate debt instrument's par amount could seldom be expected to be equal to its fair value at each reset date.) Furthermore, to qualify for cash flow hedge accounting, the hedging relationship must meet the applicable conditions in this Subtopic and the entity designating the hedge (that is, the debtor or creditor) must conclude it is probable that future interest payments will be made during the term of the interest rate swap. If the creditor's counterparty (that is, the debtor) on a recognized variable-rate asset related to the hedged forecasted interest payments can cause that asset to be prepaid, then that creditor would likely be unable to conclude that all the forecasted interest payments on its recognized interest-bearing asset are probable and, thus, the cash flow hedging relationship would not qualify for the shortcut method. (Even though the creditor believes it could immediately obtain a replacement variable-rate asset if prepayment occurs and thus could conclude that the forecasted variable interest inflows are probable, the only hedged forecasted interest inflows that are eligible for application of the shortcut method are those related to a recognized interest-bearing asset at the inception of the hedge.) However, paragraph 815-20-25-104(e) indicates that its criterion that prohibits a prepayment option in the interest-bearing asset or liability does not apply to a hedging relationship if the hedging interest rate swap contains an embedded mirror-image option. In that latter case, if both the prepayment option and the mirror-image option in the swap were exercised, there would be no future hedged interest cash flows related to the recognized interest-bearing asset or liability and no future cash flows under the swap and, thus, the existence of the prepayment option would not preclude the use of the shortcut method.

- f. Illustrative debt instrument 6. Some fixed-rate debt instruments include both a call option as described in illustrative debt instrument 1 and a contingent acceleration clause as described in illustrative debt instrument 2. The same conclusions reached relative to illustrative debt instrument 1 also apply to illustrative debt instrument 6.
- g. Illustrative debt instrument 7. Some debt instruments contain an investor protection clause (which is standard in substantially all debt issued in Europe) that provides that, in the event of a change in tax law that would subject the investor to additional incremental taxation by tax jurisdictions other than those entitled to tax the investor at the time of debt issuance, the coupon interest rate of the debt increases so that the investor's yield, net of the incremental taxation effect, is equal to the investor's yield before the tax law change. The debt issuance also contains an issuer protection clause (which is standard in substantially all debt issued in Europe) that provides that, in the event of a tax law change that triggers an increase in the coupon interest rate, the issuer has the right to call the debt obligation at par. There would be no market for the debt were it not for the prepayment and interest rate adjustment clauses that protect the issuer and investors. Illustrative debt instrument 7 is not considered prepayable under paragraph 815-20-25-104(e) because it meets the exclusion criteria under paragraph 815-20-25-113(c).

815-20-55-76 An entity is not precluded from applying the shortcut method to a fair value hedging relationship of interest rate risk involving illustrative debt instruments 1 and 6 that are prepayable due to an embedded purchased call option if the hedging interest rate swap contains an embedded mirror-image written call option.

815-20-55-77 In addition, an entity is not precluded from applying the shortcut method to a fair value hedging relationship of interest rate risk involving illustrative debt instruments 2, 3, 4, and 7 that are not considered prepayable if the hedging interest rate swap does not contain an embedded purchased or written call option related to changes in the designated benchmark interest rate.

815-20-55-78 However, an entity would likely be precluded from applying the shortcut method to a cash flow hedging relationship of interest rate risk involving illustrative debt instrument 5 because the entity would likely be unable to conclude that all the forecasted interest payments on the recognized interest-bearing asset or liability are probable.

> > > Determining Whether a Mirror-Image Call Provision Exists in Application of the Shortcut Method

815-20-55-79 This implementation guidance addresses the application of paragraph 815-20-25-104(e). It is common to quote the call prices (strike prices) on debt as a percentage of par value. In contrast, the strike prices of options

embedded in interest rate swaps are generally quoted as a rate or current yield (the current fixed-rate coupon on a noncallable-nonputtable swap having zero fair value at inception). One means of determining whether these strike prices are the same would be to:

- a. Impute the yield to maturity at a price equal to the call price for a noncallable-nonputtable debt instrument that is otherwise identical to the hedged debt instrument
- b. Compare that yield to the call or put yield embedded in the swap.

> > > Simplified Hedge Accounting Approach

815-20-55-79A In complying with the condition in paragraph 815-20-25-137(b) ~~815-20-25-131D(b)~~, comparable does not necessarily mean equal. For example, if the swap's variable rate is the London Interbank Offered Rate (LIBOR) and the borrowing's variable rate is LIBOR plus 2 percent, a 10 percent cap on the swap would be comparable to a 12 percent cap on the borrowing.

815-20-55-79B For a forward-starting swap, only the effective term of the receive-variable, pay-fixed interest rate swap (that is, from its effective date through its expiration date) shall be considered in complying with the condition in paragraph ~~815-20-25-137(f)~~ ~~815-20-25-131D(f)~~. The period from the swap's inception to the date the swap is effective shall not be considered in complying with the condition in paragraph 815-20-25-137(f) ~~815-20-25-131D(f)~~ because the effective date of a forward-starting swap occurs after the swap's inception. For example, a forward-starting receive-variable, pay-fixed, interest rate swap with a five-year effective term and an effective date commencing one year after the swap's inception would meet the condition in paragraph 815-20-25-137(f) ~~815-20-25-131D(f)~~ if designated as a hedge of a five-year, variable-rate borrowing forecasted to be entered into one year after the swap's inception.

> > > Timing of Initial Quantitative Prospective Effectiveness Assessment

815-20-55-79C The following scenarios illustrate the application of paragraph 815-20-25-3(b)(2)(iv)(02). Entity A documents all hedges in accordance with paragraph 815-20-25-3, including designating the hedging instrument, hedged item, and method of assessing hedge effectiveness. It performs subsequent prospective and retrospective hedge effectiveness assessments every three months on the last day of the quarter in accordance with paragraph 815-20-25-79(a) through (b). In the following scenarios, assume that the next quarterly effectiveness assessment date is March 31, 20X1. Entity A also does not dedesignate the hedging relationships in the following scenarios.

> > > Scenario A

815-20-55-79D Entity A enters into a cash flow hedging relationship on January 15, 20X1, in which the hedged item is a forecasted transaction expected to occur in one year. Because the hedged item and hedging instrument do not expire, are not sold, or do not terminate before the quarterly effectiveness testing date, Entity A may perform the initial prospective quantitative effectiveness assessment at any time after hedge designation but no later than March 31, 20X1.

> > > Scenario B

815-20-55-79E Entity A enters into a cash flow hedging relationship on March 28, 20X1, in which the hedged item is a forecasted transaction expected to occur in one year. Entity A must perform the initial prospective quantitative effectiveness assessment no later than March 31, 20X1.

> > > Scenario C

815-20-55-79F On January 15, 20X1, Entity A enters into a cash flow hedging relationship in which the hedged forecasted purchase of a nonfinancial asset is expected to occur in two months. The purchase occurs as forecasted on March 15, 20X1. Entity A must complete the initial prospective effectiveness assessment at any time after hedge designation but no later than March 15, 20X1, when the forecasted purchase occurs.

> > > Eligibility of Hedging Relationships for Subsequent Qualitative Effectiveness Assessments

815-20-55-79G An entity should use judgment in determining whether it can reasonably support performing assessments of effectiveness after hedge inception on a qualitative basis. That judgment should include careful consideration of the following factors:

- a. Results of the quantitative assessment of effectiveness performed for the hedging relationship.
- b. Alignment of the critical terms of the hedging relationship. If one or more of the critical terms of the hedging instrument and the hedged item are not aligned, an entity should consider whether changes in market conditions may cause the changes in fair values or cash flows of the hedging instrument and hedged item or hedged forecasted transaction attributable to the hedged risk to diverge as a result of those differences in terms.
 1. In cases in which the underlyings of the hedged item and hedging instrument are different, an entity should consider the extent and consistency of the correlation exhibited between the changes in the underlyings of the hedged item and hedging instrument.

- i. This may inform the entity about whether expected changes in market conditions could cause the changes in fair values or cash flows of the hedging instrument and the hedged item or hedged forecasted transaction attributable to the hedged risk to diverge. Particularly in the context of reverting to qualitative assessments of hedge effectiveness after being required to perform a quantitative assessment (as discussed in paragraph 815-20-35-2D), this may inform an entity about whether there is a reasonable expectation that the hedging relationship is expected to remain stable or whether that divergence is expected to continue or recur in the future.
- ii. A specific event or circumstance may cause a temporary disruption to the market that results in an entity concluding that the facts and circumstances of the hedging relationship have changed such that it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective. In those instances, if the results of the quantitative assessment of effectiveness do not significantly diverge from the results of the initial assessment of effectiveness, that market disruption should not prevent the entity from returning to qualitative testing in subsequent periods. If the results of the quantitative assessment of effectiveness do significantly diverge from the results of the initial assessment of effectiveness, the entity should continually monitor whether the temporary market disruption has been resolved when determining whether to return to qualitative testing in subsequent periods.

815-20-55-79H In the following scenarios, assume that the entity is required to perform a quantitative assessment of effectiveness at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(01). For each scenario, a discussion of whether the entity could reasonably support performing qualitative assessments of effectiveness is included in paragraphs 815-20-55-79L through 55-79N.

> > > Scenario A

815-20-55-79I The following factors are present in the hedging relationship:

- a. The results of the initial or most recent quantitative assessment of effectiveness performed indicate that the hedging relationship is close to achieving perfect offset.
- b. All critical terms of the hedging relationship match except for the underlyings of the hedged item and hedging instrument.
 1. The changes in the underlyings of the hedged item and hedging instrument have been consistently highly correlated such that

expected changes in market conditions are not anticipated to prevent the hedging relationship from achieving highly effective offset.

> > > Scenario B

815-20-55-79J The following factors are present in the hedging relationship:

- a. The results of the initial or most recent quantitative assessment of effectiveness performed indicate that the hedging relationship is close to failing the effectiveness test.
- b. All critical terms of the hedging relationship match except for the underlyings of the hedged item and the hedging instrument.
 - 1. The changes in the underlyings of the hedged item and the hedging instrument have not been consistently highly correlated such that expected changes in market conditions could prevent the hedging relationship from achieving highly effective offset.

> > > Scenario C

815-20-55-79K The following factors are present in the hedging relationship:

- a. The results of the initial or most recent quantitative assessment of effectiveness performed indicate that the hedging relationship is neither close to achieving perfect offset nor close to failing the effectiveness test.
- b. All critical terms of the hedging relationship match except for the underlyings of the hedged item and the hedging instrument.
 - 1. The changes in the underlyings of the hedged item and the hedging instrument have not been consistently highly correlated such that expected changes in market conditions could prevent the hedging relationship from achieving highly effective offset.

815-20-55-79L In Scenario A, the entity could reasonably support performing qualitative assessments of effectiveness. The quantitative assessment of effectiveness was close to achieving perfect offset and past observations of changes in the underlyings of the hedged item and hedging instrument (that is, the only critical term that did not match) consistently exhibited high correlation. This indicates that the results of subsequent assessments of effectiveness may not significantly differ from those observed from the assessment of effectiveness performed at hedge inception.

815-20-55-79M In Scenario B, the entity could not reasonably support performing qualitative assessments of effectiveness. The lack of consistent high correlation exhibited between the changes in the underlyings of the hedged item and the hedging instrument could prevent the entity from concluding that the results of subsequent assessments of effectiveness will be similar to the results observed from the initial assessment of effectiveness. Had the changes in underlyings of the hedged item and the hedging instrument been consistently highly correlated, the

entity may conclude that it is still unable to reasonably support performing subsequent assessments of effectiveness on a qualitative basis. Because the hedging relationship is close to failing its quantitative assessment, minimal changes in the relationship between the hedged item and hedging instrument could result in the hedging relationship not being highly effective.

815-20-55-79N In Scenario C, the entity could not reasonably support performing qualitative assessments of effectiveness. Although this hedging relationship is not close to failing the quantitative assessment of effectiveness as in Scenario B, the lack of consistent high correlation exhibited between the changes in the underlyings of the hedged item and the hedging instrument prevent the entity from concluding that the results of subsequent assessments of effectiveness will be similar to the results observed from the initial or most recent quantitative assessment of effectiveness. Had the changes in value of the underlyings of the hedged item and the hedging instrument consistently been highly correlated, the entity may conclude that it could reasonably support performing subsequent assessments of effectiveness on a qualitative basis.

> > > Change in Facts and Circumstances in Qualitative Effectiveness Assessments

815-20-55-79O The following scenarios illustrate the application of paragraphs 815-20-35-2A through 35-2F.

> > > Scenario A

815-20-55-79P Entity B expects to purchase 10,000 metric tons of cottonseed meal throughout April 20X3 based on the spot price of the cottonseed meal index on the respective date of each purchase. Entity B wants to hedge the variability in cash flows attributable to changes in the cottonseed meal index on the price that it will pay for the cottonseed meal. It enters into a forward contract on August 24, 20X1, with a notional of 10,000 metric tons, a maturity of April 1, 20X3, and an underlying of the soybean meal index because no market exists for derivatives indexed to the cottonseed meal index. Concurrent with the execution of the forward, Entity B designates the forward as the hedging instrument in a hedging relationship in which the hedged item is documented as the forecasted purchases of the first 10,000 metric tons of cottonseed meal expected to be purchased during April 20X3 and the hedged risk is documented as the variability in cash flows attributable to changes in the contractually specified cottonseed meal index in the not-yet-existing contract. On August 24, 20X1, Entity B determines that all requirements for cash flow hedge accounting are met and that the requirements of paragraph 815-20-25-22A will be met in the contract once executed in accordance with paragraph 815-20-25-22B. Entity B also will assess whether the criteria in 815-20-25-22A are met in the contract when it is executed.

815-20-55-79Q Because the hedged risk and forward contract are based on different indexes, the hedging relationship does not qualify for one of the exemptions in paragraph 815-20-25-3(b)(2)(iv)(01). Entity B performs an initial quantitative hedge effectiveness assessment and determines that the hedging instrument is highly effective at achieving offsetting cash flows associated with the hedged item attributable to the hedged risk. In Entity B's hedge documentation, it elects to perform subsequent assessments of hedge effectiveness on a qualitative basis. It makes this election based on the following factors:

- a. The results of the quantitative effectiveness assessment performed at hedge inception indicate that the hedging relationship is close to achieving perfect offset.
- b. Changes in the value of the cottonseed meal index have been consistently highly correlated with changes in value of the soybean meal index such that expected changes in market conditions are not anticipated to prevent the hedging relationship from achieving highly effective offset.
- c. Although the underlyings of the hedging instrument and hedged item do not match, the notional amount of the derivative and the expected quantity to be purchased do match. Based on the quantitative effectiveness assessment, Entity B also determined that the difference in timing between the maturity date of the derivative and the dates on which the group of forecasted purchases is expected to occur is insignificant.

815-20-55-79R During the fourth quarter of 20X1, a storm damages the soybean harvest, which leads to a shortage in soybean meal supply and a sharp increase in the price of soybean meal based on the soybean meal index. The cottonseed meal index has not experienced a similar increase because cotton harvests were unaffected by the storm that damaged the soybean harvest. Because the increase in the soybean meal index is not reflected in the cottonseed meal index, Entity B concludes that a change in facts and circumstance has occurred that prevents a qualitative assertion in subsequent periods that the hedging relationship continues to be highly effective at achieving offsetting cash flows. Thus, on the next subsequent effectiveness assessment date (December 31, 20X1), the company begins performing quantitative assessments of hedge effectiveness based on the method used to perform the initial prospective assessment of effectiveness. In the effectiveness assessment performed on December 31, 20X1, Entity B determines that the hedging relationship remains highly effective but that it is not close to achieving perfect offset.

815-20-55-79S Entity B returns to assessing effectiveness qualitatively as of June 30, 20X2, because the evaluation of the following criteria leads to the conclusion that high effectiveness can be asserted prospectively on a qualitative basis:

- a. Entity B determines that the event that caused the soybean meal index and cottonseed meal index to experience a lack of correlation was

- temporary, that it was an isolated weather event, and the effect of the weather event has passed.
- b. The changes in value of the soybean meal index and cottonseed meal index reverted to levels of correlation that were consistent with those before the storm.
 - c. The results of the June 30, 20X2 quantitative assessment of effectiveness are in line with the results of the quantitative assessment of effectiveness performed at hedge inception.
 - d. No further disruptions in supply are expected.

> > > Scenario B

815-20-55-79T On August 17, 20X1, Entity C issues at par a \$100 million 5-year fixed-rate noncallable debt instrument with an annual 8 percent interest coupon. On that date, Entity C enters into a 5-year interest rate swap with Financial Institution D and designates it as the hedging instrument in a fair value hedge of the LIBOR interest rate risk of the \$100 million liability. Under the terms of the interest rate swap, Entity C will receive fixed interest at 6 percent and pay variable interest at LIBOR based on a notional amount of \$100 million. The variable leg of the interest rate swap resets at the end of each quarter for the interest payment that is due at the end of the following quarter.

815-20-55-79U Entity C performs the initial quantitative and first subsequent hedge effectiveness assessments on September 30 (the entity's first quarterly testing date after hedge inception) and determines that the hedging relationship is highly effective at achieving offsetting changes in fair value attributable to interest rate risk. Entity C also elects at hedge inception to subsequently assess hedge effectiveness on a qualitative basis and documents how it would carry out that qualitative assessment. In its quarterly effectiveness assessment on December 31, the entity asserts that facts and circumstances related to the hedging relationship have not changed and the hedging relationship was and continues to be highly effective.

815-20-55-79V However, in the first quarter of 20X2, Financial Institution D's risk of default significantly increases, which affects the valuation of the interest rate swap with Entity C. Entity C notes that it no longer can qualitatively assert that the hedging relationship was and continues to be highly effective at achieving offsetting changes in fair value attributable to changes in benchmark interest rates. Thus, on the next subsequent effectiveness assessment date (March 31, 20X2), Entity C begins performing quantitative assessments of effectiveness using the method documented at hedge inception. In subsequent periods, Entity C does not return to qualitative effectiveness assessments because it cannot reasonably support an expectation of high effectiveness on a qualitative basis for the following reasons:

- a. The significant risk of default of Financial Institution D has not reversed and is not expected to be temporary.
- b. The results of quantitative effectiveness tests performed indicate that the hedging relationship is close to no longer being highly effective.

> > > Income Statement Presentation of Hedging Instruments

815-20-55-79W Paragraph 815-20-45-1A requires an entity to present the change in the fair value of the hedging instrument included in the assessment of hedge effectiveness and the amount excluded from the assessment of hedge effectiveness in the same income statement line item that is used to present the earnings effect of the hedged item. The following scenarios include implementation guidance on the meaning of the phrase *the same income statement line item that is used to present the earnings effect of the hedged item*.

> > > Scenario A

815-20-55-79X Entity A designates a fair value hedge of interest rate risk in which the hedged item is a portfolio of fixed-rate loans. The derivative designated as the hedging instrument is a receive-floating-rate, pay-fixed-rate interest rate swap. In this scenario, Entity A's objective is to convert the interest cash flows on the portfolio of fixed-rate loans to floating-rate.

815-20-55-79Y The interest rate swap is a highly effective hedge of the interest rate risk of the portfolio of fixed-rate loans. Therefore, the change in the fair value of the interest rate swap should be presented in the same income statement line item used to present the earnings effect of the hedged item. Before applying hedge accounting, the earnings effect of the hedged item (that is, the interest accruals) is presented in an interest income line item. Therefore, Entity A should present all changes in the fair value of the hedging instrument (that is, the interest accruals and all other changes in fair value) in the same interest income line item in the income statement.

> > > Scenario B

815-20-55-79Z Entity B designates a fair value hedge of foreign exchange risk in which the hedged item is an issued variable-rate debt instrument denominated in a currency other than Entity B's functional currency. The derivative designated as the hedging instrument is a receive-floating-rate (in foreign currency), pay-floating-rate (in functional currency) cross-currency swap that requires an initial and final exchange of notional amounts. In this scenario, Entity B's objective is to convert the cash flows of the debt instrument (both interest cash flows and the principal cash flow) from a foreign currency to Entity B's functional currency.

815-20-55-79AA The currency swap is a highly effective hedge of the currency risk of both the interest cash flows and the principal cash flows of the debt instrument. Therefore, the change in fair value of the currency swap should be presented in the same income statement line item(s) used to present the earnings effects of the hedged item. Before applying hedge accounting, Entity B presents the earnings effect associated with the hedged item in two income statement line items. That is, interest accruals are presented in an interest expense line item, and the spot remeasurement of the foreign-currency-denominated debt under Topic 830 on foreign currency matters is presented in a foreign currency transaction gain or loss line item. Therefore, in this scenario, because the hedging instrument is highly effective at offsetting changes in fair values associated with the hedged item that are reported in more than one income statement line item, the effects of the hedging instrument also should be presented in those corresponding income statement line items. Entity B should present all changes in the fair value of the hedging instrument (that is, the interest accruals and all other changes in fair value) in the same interest expense line item that is used to present the earnings effect of the hedged item before applying hedge accounting, except for the change in the fair value of the hedging instrument that the entity determines should be presented in the same foreign currency transaction gain or loss line item used to present the spot remeasurement of the hedged item before applying hedge accounting.

> > > Scenario C

815-20-55-79AB Entity C designates a fair value hedge of interest rate risk and foreign currency risk in which the hedged item is a foreign-currency-denominated fixed-rate available-for-sale debt security. The derivative designated as the hedging instrument is a pay-fixed-rate (in foreign currency), receive-floating-rate (in functional currency) cross-currency interest rate swap. In this scenario, Entity C's objective is to convert the interest cash flows of the fixed-rate security to floating-rate and also to convert the cash flows of the security (both interest cash flows and the principal cash flow) from a foreign currency to Entity C's functional currency.

815-20-55-79AC The cross-currency interest rate swap is a highly effective hedge of both the interest rate risk and foreign currency risk of the available-for-sale debt security. Therefore, the change in fair value of the cross-currency interest rate swap should be presented in the same income statement line item or items used to present the earnings effect of the hedged item. Before applying hedge accounting, Entity C recognizes the earnings effect of the hedged item (that is, interest accruals on the available-for-sale debt security) in an interest income line item in the income statement and recognizes all other changes in fair value in other comprehensive income in accordance with paragraph 320-10-35-1(b). Entity C should present changes in fair value of the hedging instrument (that is, the interest accruals and all other changes in fair value) in the same income statement line

item used to present the earnings effect of the hedged item. However, if Entity C's policy is to present the effect of foreign exchange rate changes on the fair value of the security that are recognized in earnings after applying hedge accounting in accordance with paragraph 815-25-35-6 in a different income statement line item (consistent with its presentation policies when reflecting other foreign exchange rate changes), then the related changes in fair value of the hedging instrument also should be presented in that income statement line item.

815-20-55-79AD This scenario illustrates that a single hedging instrument (a cross-currency interest rate swap) may be highly effective at offsetting changes in fair values or cash flows associated with the hedged item in which the earnings effect of the hedged item is presented in more than one income statement line item. If a hedging instrument is highly effective at offsetting changes in fair values or cash flows of the hedged item and the earnings effect of the hedged item is presented in more than one income statement line item, then the earnings effects of the hedging instrument also should be presented in those corresponding income statement line item(s).

> Illustrations

> > Example 1: Designation and Documentation of Hedged Forecasted Transaction

815-20-55-80 This Example illustrates the requirement in paragraph 815-20-25-3(d)(1) for specific identification of the hedged transaction. Entity A determines with a high degree of probability that it will issue \$5,000,000 of fixed-rate bonds with a 5-year maturity sometime during the next 6 months, but it cannot predict exactly when the debt issuance will occur. That situation might occur, for example, if the funds from the debt issuance are needed to finance a major project to which Entity A is already committed but the precise timing of which has not yet been determined. To qualify for cash flow hedge accounting, Entity A might identify the hedged forecasted transaction as, for example, the first issuance of five-year, fixed-rate bonds that occurs during the next six months.

> > Example 1A: Documentation When the Critical Terms of the Hedging Instrument and Hedged Forecasted Transaction Match

815-20-55-80A This Example illustrates the documentation requirements in paragraph 815-20-25-3 when the critical terms of the hedging instrument and hedged forecasted transaction match in accordance with paragraphs 815-20-25-84 through 25-85. On January 1, 20X1, Entity A, a U.S. dollar (USD) functional currency entity, executes a forward contract to hedge a portion of its exposure to Canadian Dollar- (CAD-) denominated forecasted sales expected to occur in December 20X1. Entity A determines that all the critical terms of the hedging

instrument and hedged forecasted transaction match. It documents the hedging relationship concurrently with the execution of the forward contract in accordance with paragraph 815-20-25-3 as follows:

- a. Risk management objective: To hedge against movements in the USD/CAD exchange rate that will affect the USD value of future CAD sales.
- b. Hedged forecasted transaction: The first CAD 500,000 sales in December 20X1.
- c. Hedging instrument: Foreign exchange forward contract to sell CAD 500,000 and receive USD 400,000 on December 31, 20X1. The fair value of the forward contract at hedge inception is zero.
- d. Method of assessing hedge effectiveness: Entity A will assess the effectiveness on a qualitative basis at hedge inception. The critical terms of the hedging instrument and hedged forecasted transaction can be considered to match because the notional amounts and underlyings of the hedging instrument and hedged forecasted transaction are the same and the forecasted sales are expected to occur in the same fiscal month as the maturity date of the hedging instrument. Therefore, the hedge is expected to be perfectly effective. Subsequent assessments of effectiveness will be performed by verifying and documenting whether the critical terms of the hedging instrument and hedged forecasted transaction have changed during the period in review and whether it remains probable that the counterparty to the hedged item and hedged forecasted transactions will not default. If there are no such changes in critical terms or counterparty credit risk, Entity A will continue to conclude that the hedging relationship is perfectly effective.

> > Example 2: Portions and Portfolios of Individual Items as Hedged Item

815-20-55-81 This Example illustrates the application of paragraph 815-20-25-12.

815-20-55-82 An entity that issues \$100 million of fixed-rate debt may wish to hedge 50 percent of its fair value exposure to interest rate risk, as permitted by paragraph 815-20-25-12(b)(2). To accomplish that, the entity could enter into an interest rate swap with a notional amount of \$50 million. The paragraph 815-20-25-104(a) criterion is satisfied because the entity has designated as a fair value hedge 50 percent of the contractual principal amount as the hedged item and has entered into an interest rate swap with a notional amount that matches the hedged principal amount.

815-20-55-83 If \$100 million of fixed-rate debt were issued in increments of \$1,000 individual bonds, the entity could aggregate 50,000 of those individual bonds as a portfolio to equal the notional amount of the swap, as permitted by paragraph 815-20-25-12(b)(1) (for the purposes of this Example, it is assumed that the hedge satisfies the portfolio requirements of that paragraph).

> > Example 3: Firm Commitment as Hedged Item in Relation to Long-Term Supply Contracts with Embedded Price Caps or Floors

815-20-55-84 This Example illustrates the application of paragraph 815-20-25-12 and the definition of firm commitment in relation to long-term supply contracts with embedded price caps or floors.

815-20-55-85 Entity A enters into a long-term supply contract with a customer to sell a specified amount of a certain material. The selling price is the current monthly average list price for the quantity delivered each month but not to exceed \$15 per pound. The current list price at the contract signing date is \$12 per pound. The contract can be settled only by physical delivery. The contract also includes a penalty provision that is sufficiently large to make performance probable. The customer is not required to make an up-front cash payment for the written option (that is, the price cap) in the supply contract. Consequently, the supply contract is neither a recognized asset nor a recognized liability at inception.

815-20-55-86 The supply contract in its entirety does not meet the definition of a derivative instrument due to the absence of a net settlement characteristic—that is, the contract does not permit or require net settlement (see guidance beginning in paragraph 815-10-15-100), there is no market mechanism (see guidance beginning in paragraph 815-10-15-110), and it does not require delivery of an asset that is **{add glossary link}** readily convertible to cash **{add glossary link}** (see guidance beginning in paragraph 815-10-15-119). Pursuant to the guidance in paragraph 815-15-25-19, the embedded cap on the selling price is an option that does not warrant separate accounting under Subtopic 815-15 because it is clearly and closely related to the host supply contract. In addition, because the supply contract is not remeasured with changes in fair value reported currently in earnings, it meets the criteria in paragraph 815-20-25-43(c)(3) ~~815-20-25-41(c)(3)~~ to qualify as a hedged item in a fair value hedge.

815-20-55-87 Entity A wishes to enter into a transaction to hedge the risk of changes in the fair value of the embedded written price cap in the supply contract. Accordingly, it purchases a cash-settled call option with a strike price of \$15 per pound and a notional amount equal to the quantity specified in the supply contract. In accordance with the guidance in paragraph 815-20-25-12, a supply contract for which the contract price is fixed only under certain circumstances (such as when market prices are above an embedded price cap) meets the definition of a firm commitment for purposes of designating the hedged item in a fair value hedge. Therefore, if the selling price in a supply contract is subject to a cap, a floor, or both, either party to the contract is eligible to apply fair value hedge accounting in a hedging relationship to hedge the fair value exposure of the cap or floor. For the range of monthly average list prices above \$15 per pound, the contract has a fixed \$15 per pound price. Thus, Entity A may designate the written cap embedded in the supply contract as the hedged item in a fair value hedging relationship provided

the other criteria for a fair value hedge are met. The embedded written cap in this Example is a specific portion of the contract that is subject to the risk of changes in fair value due to changes in the list price of the underlying materials. Because it is not accounted for separately from the supply contract, the embedded written cap may be designated as the hedged item in a fair value hedge. Paragraph 815-20-25-12 allows a nonbifurcated call option that is embedded in a supply contract to be the hedged item in a fair value hedge regardless of whether that supply contract is a recognized asset or liability or an unrecognized firm commitment.

> > Example 4: Variable Interest Payments on a Group of Variable-Rate, Interest-Bearing Loans as Hedged Item

815-20-55-88 The following Cases illustrate the implications of two different approaches to designation of variable interest payments on a group of variable-rate, interest-bearing loans:

- a. Designation based on first payments received (Case A)
- b. Designation based on a specific group of individual loans (Case B).

815-20-55-89 For Cases A and B, assume Entity A and Entity B both make to their respective customers London Interbank Offered Rate- (LIBOR-) indexed variable-rate loans for which interest payments are due at the end of each calendar quarter, and the LIBOR-based interest rate resets at the end of each quarter for the interest payment that is due at the end of the following quarter. Both entities determine that they will each always have at least \$100 million of those LIBOR-indexed variable-rate loans outstanding throughout the next 3 years, even though the composition of those loans will likely change to some degree due to prepayments, loan sales, and potential defaults.

815-20-55-90 This Example does not address cash flow hedging relationships in which the hedged risk is the risk of overall changes in the hedged cash flows related to an asset or liability, as discussed in paragraph 815-20-25-15(j)(1). ~~Example 29 (see paragraph 815-20-55-226) illustrates application of a comparable first payments received technique in hedging variable nonbenchmark interest payments on a group of loans.~~

> > > Case A: Designation Based on First Payments Received

815-20-55-91 In this Case, Entity A wishes to hedge its interest rate exposure to changes in the quarterly interest receipts on \$100 million principal of those LIBOR-indexed variable-rate loans by entering into a 3-year interest rate swap that provides for quarterly net settlements based on Entity A receiving a fixed interest rate on a \$100 million notional amount and paying a variable LIBOR-based rate on a \$100 million notional amount.

815-20-55-92 In a cash flow hedge of interest rate risk, Entity A may identify the hedged forecasted transactions as the first LIBOR-based interest payments received by Entity A during each 4-week period that begins 1 week before each quarterly due date for the next 3 years that, in the aggregate for each quarter, are payments on \$100 million principal of its then existing LIBOR-indexed variable-rate loans. The LIBOR-based interest payments received by Entity A after it has received payments on \$100 million aggregate principal would be unhedged interest payments for that quarter.

815-20-55-93 The hedged forecasted transactions for Entity A in this Case are described with sufficient specificity so that when a transaction occurs, it is clear whether that transaction is or is not the hedged transaction.

815-20-55-94 Because Entity A has designated the hedging relationship as hedging the risk of changes attributable to changes in the LIBOR benchmark interest rate in Entity A's first LIBOR-based interest payments received, any prepayment, sale, or credit difficulties related to an individual LIBOR-indexed variable-rate loan would not affect the designated hedging relationship.

815-20-55-95 Provided Entity A determines it is probable that it will continue to receive interest payments on at least \$100 million principal of its then existing LIBOR-indexed variable-rate loans, Entity A can conclude that the hedged forecasted transactions in the documented cash flow hedging relationships are probable of occurring.

815-20-55-96 An entity may not assume perfect effectiveness ~~no ineffectiveness~~ in such a hedging relationship as described in paragraph 815-20-25-102 because the hedging relationship does not involve hedging the interest payments related to the same recognized interest-bearing loan throughout the life of the hedging relationship. Consequently, at a minimum, Entity A must consider the timing of the hedged cash flows vis-à-vis the swap's cash flows when assessing effectiveness and calculating ineffectiveness.

> > > Case B: Designation Based on a Specific Group of Individual Loans

815-20-55-97 In this Case, Entity B wishes to hedge its interest rate exposure to changes in the quarterly interest receipts on \$100 million principal of those LIBOR-indexed variable-rate loans by entering into a 3-year interest rate swap that provides for quarterly net settlements based on Entity B receiving a fixed interest rate on a \$100 million notional amount and paying a variable LIBOR-based rate on a \$100 million notional amount. Entity B initially designates cash flow hedging relationships of interest rate risk and identifies as the related hedged forecasted transactions each of the variable interest receipts on a specified group of individual LIBOR-indexed variable-rate loans aggregating \$100 million principal but then

some of those loans experience prepayments, are sold, or experience credit difficulties.

815-20-55-98 This Case addresses whether the original cash flow hedging relationships remain intact if the composition of the group of loans whose interest payments are the hedged forecasted transactions is changed by replacing the principal amount of the specified loans with similar variable-rate interest-bearing loans. Entity B cannot conclude that the original cash flow hedging relationships have remained intact if the composition of the group of loans whose interest payments are the hedged forecasted transactions is changed by replacing the principal amount of the originally specified loans with similar variable-rate interest-bearing loans. Paragraph 815-20-25-15(a) requires that, for a cash flow hedge, the forecasted transaction be specifically identified as a single transaction or group of transactions. At inception, the entity designated cash flow hedging relationships for each of the variable interest receipts on a specified group of ~~benchmark-interest-rate-based~~ variable-rate loans. If a loan within the group experiences a prepayment, has been sold, or experiences an unexpected change in its **expected cash flows** due to credit difficulties, the remaining hedged interest payments to Entity B specifically related to that loan are now no longer probable of occurring. Pursuant to paragraphs 815-30-40-1 through 40-3, Entity B must discontinue the hedging relationships with respect to the hedged forecasted transactions that are now no longer probable of occurring. However, had the hedged forecasted transactions been designated in a manner similar to that described in Case A, the consequences of a loan's prepayment, a loan sale, or an unexpected change in a loan's expected cash flows due to credit difficulties would not have been the same. How the forecasted transaction in a cash flow hedge is designated can have a significant ~~impact~~ effect on the application of the Derivatives and Hedging Topic.

815-20-55-99 Changing the composition of the specified individual loans within the group of variable-rate interest-bearing loans due to prepayment, a loan sale, or an unexpected change in a loan's expected cash flows due to credit difficulties reflects a change in the probability of the identified hedged forecasted transactions for the hedging relationships related to the individual loans removed from the group of variable-rate interest-bearing loans. Consequently, the hedging relationships for future interest payments that are no longer probable of occurring must be terminated. The provisions related to immediately reclassifying a derivative instrument's gain or loss out of accumulated other comprehensive income into earnings are based on the hedged forecasted transaction being probable that it will not occur—not no longer being probable of occurring—and includes consideration of an additional two-month period of time. After the discontinuation of the hedging relationships for interest payments related to the individual loans removed from the group of variable-rate interest-bearing loans and the reclassification into earnings of the net gain or loss in accumulated other comprehensive income related to those hedging relationships, the derivative instrument (or a proportion thereof) specifically related to the hedging relationships that have been terminated is eligible to be redesignated as the hedging instrument

in a new cash flow hedging relationship. However, paragraph 815-30-40-5 warns that a pattern of determining that hedged forecasted transactions are probable of not occurring ~~probably will not occur~~ would call into question both the entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions.

> > Example 5: Hedged Forecasted Transaction When Timing Involves Some Uncertainty within a Range

815-20-55-100 This Example illustrates the application of paragraph 815-20-25-16(c).

815-20-55-101 A general contractor enters into a long-term contract to build a power plant. The long-term contract is to be completed within five years. As part of the construction project, the general contractor expects to subcontract a portion of the construction to a foreign entity with a functional currency different from its own. Because the subcontractor will be paid in its functional currency, the general contractor will have a foreign currency exposure that it desires to hedge. At the start of the project, the general contractor concludes it is probable that the subcontract work will be completed and paid for at the end of Year 2. However, the general contractor knows that the timing of a subcontractor's work, and thus the foreign-currency-denominated payment for its work, may possibly be delayed by a period of more than two months, even though it is probable that the overall project will remain on schedule in meeting the ultimate completion date. The contractor intends to hedge the exposure by using a forward contract with a maturity date that coincides with the current expected date of payment (that is, a two-year foreign currency forward) and the expected notional amount of the forecasted transaction.

815-20-55-102 The general contractor could document (as required by paragraph 815-20-25-3(d)(1)) that the hedged forecasted transaction is the foreign-currency-denominated payment to the foreign subcontractor to be paid within the five-year contract period of the overall project (which is the originally specified time period referred to in paragraphs 815-30-40-4 through 40-5). In accordance with paragraph 815-20-25-16(c), as long as it remains probable that the forecasted transaction will occur by the end of the originally projected five-year period of the overall project, cash flow hedge accounting for that hedging relationship would continue. Consequently, if the subcontractor's payment is delayed by more than two months, but less than three years and two months, then the forecasted transaction would still be considered probable of occurrence within the originally specified time period.

815-20-55-103 If the expected timing of the forecasted transaction changes, the contractor must first apply the requirements of paragraph 815-30-35-3 using its originally documented hedging strategy and the newly revised best estimate of the cash flows, and then reevaluate whether continuing hedge accounting is

appropriate, pursuant to the requirements of paragraphs 815-30-40-1 through 40-3. If hedge accounting is discontinued prospectively, the derivative instrument's gains or losses in other comprehensive income ~~after the application of paragraph 815-30-35-3(b)~~ should be accounted for pursuant to paragraphs 815-30-35-38 through 35-41 (unless paragraphs 815-30-40-4 through 40-5 require reclassification into earnings).

815-20-55-104 ~~Paragraph 815-30-35-3 requires recognition of cumulative ineffectiveness for overhedges. This could result in an entity reporting a significant amount of ineffectiveness in income (in essence a catch up adjustment) in the period that a change is made in the expected future cash flows on the hedged forecasted transaction from the inception of the hedge. Specifically, the final measurement under paragraph 815-30-35-3(b)(2) should be based on the most recent best estimate of the hedged forecasted transaction as of the date that a cash flow hedge is discontinued prospectively. If a quantitative assessment of hedge effectiveness is applied and the assessment of effectiveness is based on changes in forward rates, the most recent best estimate would be based on the current forward rate for the hedged transaction relevant for the probable date that the transaction will occur. If the assessment of effectiveness is based on changes in spot rates, the best estimate would be based on the current spot rate.~~

> > Example 6: Prohibition on Characterization of Variable-Rate Debt as Rolled Fixed-Rate Debt

815-20-55-105 This Example illustrates the application of paragraph 815-20-25-19. Consider an entity with existing variable-rate debt that is prepayable, resets monthly based on a specified bank's prime rate plus 1 percent as of the beginning of each month, and matures in 5 years. Although the variable-rate debt does, after each reset, have a fixed rate for each monthly period, it is inappropriate to characterize that debt as a series of fixed-rate debt instruments ~~whose issuances would not be subject to the restriction against hedging interest rate risk in paragraphs 815-20-25-15(j) and 815-20-25-19. When each reset occurs, it is not a new issuance of fixed-rate debt based on current market interest rates for that debtor; instead, it is a contractual continuation of a debtor-creditor relationship and the fixed rate for each month is explicitly (and contractually) based on a specific index (a specified bank's prime rate) that is different from a designated benchmark interest rate. Thus, the restriction against hedging interest rate risk in paragraph 815-20-25-15(j) must be applied to the variable rate debt instrument.~~

> > Example 7: Determination of the Appropriate Hypothetical Derivative for Variable-Rate Debt That Is Prepayable at Par at Each Interest Reset Date

815-20-55-106 This Example illustrates the application of paragraph 815-20-25-20.

815-20-55-107 Entity A issues variable-rate debt that is prepayable at par on each interest rate reset date. The credit sector spread on the debt issuance is not reset on the interest rate reset dates. Specifically, the debt bears interest at a rate of LIBOR plus 100 basis points, with LIBOR reset every quarter. Entity A also enters into a receive-variable, pay-fixed interest rate swap that is designated as a hedge of the variability in the debt interest payments due to changes in the benchmark contractually specified interest rate (LIBOR). During the term of the hedging relationship (that is, the specific term of the interest rate swap), Entity A expects to issue new variable-rate debt (in the event the original debt is repaid before maturity) to maintain an aggregate debt principal balance equal to or greater than the notional amount of the interest rate swap, and expects the new debt (if any) to share the key characteristics of the original debt issuance (specifically, quarterly repricing to the LIBOR index and no minimum, maximum, or periodic constraints of the debt interest rate). The hedging relationship meets all of the criteria for shortcut method accounting beginning in paragraph 815-20-25-102 except for the criterion in paragraph 815-20-25-104(e); the debt is prepayable and the interest rate swap does not contain a mirror-image call option to match the call option embedded in the debt instrument, as required by that paragraph.

815-20-55-108 Entity A wishes to apply the hypothetical derivative method (as described beginning in paragraph 815-30-35-25) for its initial and subsequent quantitative assessments of hedge effectiveness ~~to calculate the amount of in effectiveness in the hedging relationship to be recognized in earnings in accordance with paragraph 815-30-35-3(b)).~~ Because the actual interest rate swap used in Entity A's hedging relationship already meets all of the criteria in paragraph 815-20-25-102 except the criterion in paragraph 815-20-25-104(e), this guidance would seem to suggest that the hypothetical interest rate swap would need to be the same as the actual interest rate swap except that a mirror-image call option would need to be added to meet the criterion in that paragraph and the guidance beginning in paragraph 815-30-35-10. However, Entity A observes that because the hedged transactions are the variable interest payments (on debt with a principal amount equal to the notional amount of the swap) due to changes in the benchmark contractually specified interest rate (LIBOR), and because the transaction had to be probable of occurring under paragraph 815-20-25-15(b) for it to qualify for hedge accounting, the actual swap would be expected to perfectly offset the hedged cash flows.

815-20-55-109 In this fact pattern, the hypothetical interest rate swap under the guidance beginning paragraph 815-30-35-10 would be the same as the actual interest rate swap described in this Example. Because Entity A has concluded that if the original debt issuance is repaid before maturity, it is probable that a sufficient principal amount of variable-rate debt with key characteristics that match those of the original debt issuance (specifically quarterly repricing to the LIBOR index and no minimum, maximum, or periodic constraints of the debt interest rate) will be issued and remain outstanding during the term of the hedging relationship (providing exposure to ~~benchmark-~~ LIBOR-interest-rate-based variable cash

payments), the prepayment provisions of the debt instrument should not be considered in determining the appropriate hypothetical derivative under that guidance. The prepayment of the original variable-rate debt eliminates the contractual obligation to make those interest payments; however, this Subtopic permits replacing the hedged interest payments that are no longer contractually obligated to be paid without triggering the dedesignation of the original cash flow hedging relationship. Replacing the original debt issuance with a new variable-rate debt issuance is permissible in a cash flow hedge of interest rate risk and does not automatically result in the discontinuation of the original cash flow hedging relationship.

815-20-55-110 Although the entity can terminate the debt at any interest rate reset date for reasons that may be totally unrelated to changes in the ~~benchmark~~ contractually specified interest rate (which is the hedged risk), it expects to be at risk for variability in cash flows due to changes in the contractually specified ~~benchmark~~ interest rate in an amount based on debt principal equal to or greater than the notional amount of the swap during the specific term of the interest rate swap. Therefore, the prepayment feature of the debt is not relevant for purposes of determining the appropriate hypothetical swap under the guidance beginning in paragraph 815-30-35-10 as long as the relevant conditions to qualify for cash flow hedge accounting have been met with respect to the hedged transaction.

> > Example 8: All-in-One Hedges

815-20-55-111 The following Cases illustrate the application of paragraph 815-20-25-21:

- a. Purchase of a nonfinancial asset (Case A)
- b. Purchase of a financial asset (Case B).

815-20-55-112 Settling a forward contract gross involves delivery of an asset in exchange for the payment of cash or other assets and is differentiated from settling net, which typically involves a payment for the change in a contract's value as the method of settling the contract.

815-20-55-113 A forecasted purchase or sale meets the definition of forecasted transaction and, if it is probable, meets the criteria in paragraph 815-20-25-15 for designation as a hedged transaction. An entity concerned about variability in cash flows from its forecasted purchases or sales can economically fix the price of those purchases or sales by entering into a fixed-price contract. Because the fixed-price purchase or sale contract is a derivative instrument, it is eligible for use as a hedging instrument.

815-20-55-114 The forecasted purchase or sale at a fixed price is eligible for cash flow hedge accounting because the total consideration paid or received is variable. The total consideration paid or received for accounting purposes is the sum of the

fixed amount of cash paid or received and the fair value of the fixed price purchase or sale contract, which is recognized as an asset or liability, and which can vary over time.

> > Case A: Purchase of a Nonfinancial Asset

815-20-55-115 Entity A plans to purchase a nonfinancial asset. To fix the price to be paid (that is, to hedge the price), Entity A enters into a contract that meets the definition of a firm commitment with an unrelated party to purchase the asset at a fixed price at a future date. Assume that the terms of the contract (such as net settlement under the default provisions) or the nature of the asset cause the contract to meet the definition of a derivative instrument and the contract is not excluded by paragraphs 815-10-15-13 through 15-82 from the scope of the Derivatives and Hedging Topic. As such, Entity A has entered into a derivative instrument under which it is expected to take delivery of the asset. Entity A may designate the fixed-price purchase contract (that is, the derivative instrument) as a cash flow hedge of the variability of the consideration to be paid for the purchase of the asset (that is, the forecasted transaction) even though the derivative instrument is the same contract under which the asset itself will be acquired.

> > Case B: Purchase of a Financial Asset

815-20-55-116 Entity B plans to purchase U.S. government bonds and expects to classify those bonds in its available-for-sale portfolio. To fix the price to be paid (that is, to hedge the price), Entity B enters into a contract that meets the Derivatives and Hedging Topic's definition of a firm commitment with an unrelated party to purchase the bonds at a fixed price at a future date. Assume the contract meets the definition of a derivative instrument and is not excluded by paragraphs 815-10-15-13 through 15-82 from the scope of this Topic. As such, Entity B has entered into a derivative instrument under which it is expected to take delivery of the asset. Entity B may designate the fixed-price purchase contract (that is, the derivative instrument) as a cash flow hedge of the variability of the consideration to be paid for the purchase of the bonds (that is, the forecasted transaction) even though the derivative instrument is the same contract under which the asset itself will be acquired.

> > Example 9: Definition of Hedged Item When Using a Zero-Cost Collar with Different Notional Amounts

815-20-55-117 The following Example illustrates the application of paragraph 815-20-25-10 to a currency collar.

- a. Subparagraph superseded by Accounting Standards Update No. 2016-01

- b. Subparagraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-118 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-119 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-120 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-121 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-122 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-123 Entity B forecasts that it will purchase inventory that will cost 100 million foreign currency (FC) units. Entity B's functional currency is the U.S. dollar (USD). To limit the variability in USD-equivalent cash flows associated with changes in the USD-FC exchange rate, Entity B constructs a currency collar as follows:

- a. A purchased call option providing Entity B the right to purchase FC 100 million at an exchange rate of USD 0.885 per FC 1.
- b. A written put option obligating Entity B to purchase FC 50 million at an exchange rate of USD 0.80 per FC 1.

815-20-55-124 The purchased call option provides Entity B with protection when the USD-FC exchange rate increases above USD 0.885 per FC 1. The written put option partially offsets the cost of the purchased call option and obligates Entity B to give up some of the foreign currency gain related to the forecasted inventory purchase as the USD-FC exchange rate decreases below USD 0.80 per FC 1. (For both options, the underlying is the same—the USD-FC exchange rate.) Assuming that a net premium was not received for the combination of options and all the other criteria in paragraphs 815-20-25-89 through 25-90 have been met, if Entity B chooses to use the combination of options as a hedging instrument, it is not required to comply with the provisions contained in paragraph 815-20-25-94 related to written options.

815-20-55-125 Entity B would like to designate the combination of options as a hedge of the variability in USD-equivalent cash flows of its forecasted purchase of inventory denominated in FC. Assume Entity B specifies in the hedge effectiveness documentation that the collar's time value would be excluded from the assessment of hedge effectiveness.

815-20-55-126 The hedging relationship involving the currency collar designated as a hedge of the effect of fluctuations in the USD-FC exchange rate qualifies for cash flow hedge accounting. In that example, the hedged risk is the risk of changes in USD-equivalent cash flows attributable to foreign currency risk (specifically, the risk of fluctuations in the USD-FC exchange rate). The foreign currency collar is hedging the variability in USD-equivalent cash flows for 100 percent of the forecasted FC 100 million purchase price of inventory for USD-FC exchange rate movements above USD 0.885 per FC 1 and variability in USD-equivalent cash flows for 50 percent of the forecasted FC 100 million purchase price of inventory for USD-FC exchange rate movements below USD 0.80 per FC 1. Cash flow hedge ~~effectiveness will be determined based on accounting will be applied for these~~ changes in the underlying (the USD-FC exchange rate) that cause changes in the collar's intrinsic value (that is, changes below USD 0.80 per FC 1 and above USD 0.885 per FC 1). Because the hedge's effectiveness is based on changes in the collar's intrinsic value, hedge effectiveness must be assessed based on the actual exchange rate changes by comparing the change in intrinsic value of the collar to the change in the specified quantity of the forecasted transaction for those changes in the underlying.

> > Example 10: Foreign-Currency-Denominated Debt Instrument as both Hedging Instrument and Hedged Item

815-20-55-127 This Example illustrates the application of paragraph 815-20-55-38.

815-20-55-128 A U.S. parent entity (Parent A) with a U.S. dollar (USD) functional currency has a German subsidiary that has the Euro (EUR) as its functional currency. On January 1, 2001, Parent A issues a five-year, fixed-rate EUR-denominated debt instrument and designates that EUR-denominated debt instrument as a hedge of its net investment in the German subsidiary. On the same date, Parent A enters into a five-year EUR-denominated receive-fixed, pay-Euribor-interest rate swap. Parent A designates the interest rate swap as a hedge of the foreign-currency-denominated fair value of the fixed-rate EUR-denominated debt instrument attributable to changes in Euribor interest rates, which is considered the benchmark interest rate for a hedge of the EUR-denominated fair value of that instrument.

815-20-55-129 As permitted by paragraph 815-20-55-38, Parent A may designate the EUR-denominated debt instrument as a hedge of its net investment in the German subsidiary and also as the hedged item in a fair value hedge of the debt instrument's foreign-currency-denominated fair value attributable to changes in the designated benchmark interest rate. As a result of applying fair value hedge accounting, the debt's carrying amount will be adjusted to reflect changes in its foreign-currency-denominated fair value attributable to interest rate risk. The notional amount of the debt that is designated as the hedging instrument in the net

investment hedge will change over time such that it may not match the notional amount of the hedged net investment. The entity then applies the net investment hedge guidance in Subtopic 815-35 and the fair value hedge guidance in Subtopic 815-25. As discussed in ~~paragraph 815-35-35-19(a)~~ paragraphs 815-35-35-13 through 35-14, because the notional amount of the ~~derivative~~ nondervative instrument designated as a hedge of the net investment does not match the portion of the net investment designated as being hedged, ~~the amount of hedge effectiveness ineffectiveness required to be recognized in earnings is assessed measured~~ by comparing the following two values:

- a. The foreign currency transaction gain or loss based on the spot rate change (after tax effects, if appropriate) of that nondervative hedging instrument ~~The change in fair value of the actual derivative instrument designated as the hedging instrument~~
- b. The transaction gain or loss based on the spot rate change (after tax effects, if appropriate) that would result from the appropriate hypothetical nondervative instrument that has a notional amount that matches the portion of the net investment being hedged. The hypothetical nondervative instrument also would have a maturity that matches the maturity of the actual nondervative instrument designated as the net investment hedge. The change in fair value of a hypothetical derivative instrument that has a notional amount that matches the portion of the net investment being hedged and a maturity that matches the maturity of the actual derivative instrument designated as the net investment hedge.

> > Example 11: Identifying an Intervening Subsidiary with a Different Functional Currency

815-20-55-130 This Example illustrates the application of paragraph 815-20-25-30(a)(2). If a dollar- (USD-) functional, second-tier subsidiary has a Euro (EUR) exposure, the USD-functional consolidated parent entity could designate its USD–EUR derivative instrument as a hedge of the second-tier subsidiary's exposure if the functional currency of the intervening first-tier subsidiary (that is, the parent of the second-tier subsidiary) is also USD. In contrast, if the functional currency of the intervening first-tier subsidiary was the Japanese yen (JPY) (thus requiring the financial statements of the second-tier subsidiary to be translated into JPY before the JPY-denominated financial statements of the first-tier subsidiary are translated into USD for consolidation), the consolidated parent entity could not designate its USD–EUR derivative instrument as a hedge of the second-tier subsidiary's exposure.

> > Example 12: Grandfathered Hybrid Instrument as a Hedged Item

815-20-55-131 This Example illustrates how an entity may achieve hedge accounting for a hedge of a **hybrid instrument** that was not separated into a host

contract and {add glossary link}embedded derivative{add glossary link} instrument because of grandfathering provisions applied when the guidance in the Derivatives and Hedging Topic initially took effect. During January 1998, Entity A issued a \$100 million structured note that pays quarterly a 3 percent annual rate of interest plus an additional quarterly return based on any increase in the Standard and Poor's S&P 500 Index for that quarter, with a guaranteed return of principal at maturity. Because of grandfathering provisions when the guidance in this Topic initially took effect, the embedded equity derivative instrument was not separated from the debt host contract. The following guidance relates to Entity A's ability to designate various fair value and cash flow hedging relationships involving the example structured note:

- a. Entity A may designate a fair value hedge of the risk of changes in the structured note's overall fair value. Because Entity A must have an expectation at the inception of the hedge and on an ongoing basis that the hedging relationship will be highly effective in achieving offsetting changes in fair value during the period the hedge is designated, it must obtain a derivative instrument or combination of derivative instruments that would be a highly effective hedge of changes in the structured note's overall fair value. While this strategy is permitted, it may be difficult to construct a hedging instrument that is highly effective in offsetting the interest-rate-based and equity-based components of the structured note's return while also encompassing a hedge of credit risk exposure. However, if it is expected that the embedded equity-based component of the structured note will generate de minimis changes in fair value during the hedge period, an expectation of high effectiveness may be established.
- b. Entity A may designate a fair value hedge of the risk of changes in the fair value of the embedded equity derivative that is not being accounted for separately. The equity-based component of the structured note is an equity derivative that provides the holder of the structured note with potential gains resulting from increases in the S&P 500 Index. That equity derivative can be identified as the hedged item because it is a portion of a recognized liability that meets the requirements in paragraph 815-20-25-12(b)(2)(iii).
- c. Entity A may designate a fair value hedge of the risk of changes in the structured note's fair value attributable to changes in the designated benchmark interest rate (for example, the U.S. Treasury rate). Similar to the hedging relationship discussed under (a), Entity A must have an expectation at the inception of the hedge and on an ongoing basis that the hedging relationship will be highly effective in achieving offsetting changes in fair value attributable to the benchmark interest rate during the period the hedge is designated. If Entity A calculates the change in the fair value of the hedged item attributable to interest rate risk based on the full contractual coupon cash flows, However, it is unlikely that Entity A it could establish an expectation that a derivative instrument based on

the benchmark interest rate would be highly effective as a hedge of the structured note's fair value attributable to interest rate risk because of the ~~impact effect~~ of the equity-based-component on the calculation of that change in fair value attributable to interest rate risk. ~~As required by paragraph 815-20-25-12(f), the estimated cash flows used in calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate must be based on all of the contractual cash flows of the entire hedged item; excluding some of the hedged item's contractual cash flows is not permitted.~~ Therefore, in employing this ~~measurement methodology hedging strategy~~, Entity A must incorporate into that calculation the cash flows that will be generated by both the structured note's interest-rate-based component (based on the 3 percent fixed rate) and an estimation of the cash flows that will be generated by the equity-based component (based on expected increases in the S&P 500 Index). While this hedging relationship would typically be expected not to qualify as a fair value hedge of interest rate risk, if it is expected that the embedded equity-based component of the structured note will have a de minimis effect on the changes in fair value of the structured note during the hedge period, an expectation that the hedging relationship will be highly effective in achieving offsetting changes in fair value attributable to interest rate risk may be established. Alternatively, Entity A may calculate the change in the fair value of the hedged item attributable to interest rate risk using the benchmark interest rate component of the contractual coupon cash flows determined at hedge inception. In employing this measurement methodology, Entity A should not estimate the hedged item's cash flows expected to be generated by the equity-based component.

- d. Entity A may designate a cash flow hedge of the risk of changes in the structured note's total quarterly cash flows. To be highly effective, the entity would be required to designate as the hedging instrument a derivative instrument that is expected to produce offsetting cash flows as the S&P 500 Index increases.
- e. Entity A may not designate a cash flow hedge of the interest rate risk of changes in the structured note because it does not have a contractually specified interest rate, note's cash flows attributable to changes in the designated benchmark interest rate (for example, the U.S. Treasury rate). ~~In accordance with paragraph 815-20-25-15(j), to designate a hedge of cash flow variability attributable to changes in the benchmark interest rate, the hedged variable interest flows must be explicitly based on the designated benchmark rate (that is, either the U.S. Treasury rate or the LIBOR swap rate in the United States). If the hedged transaction's variability is based on an index other than the designated benchmark rate, the risk being hedged must be the risk of overall changes in the hedged cash flows, as discussed in (d). The variability in the structured note's cash flows is based on changes in the S&P 500 Index, not the designated benchmark rate.~~

> > Example 13: Eliminating All Variability in Cash Flows

815-20-55-132 The following Cases illustrate the application of paragraph 815-20-25-39(d) regarding whether all the variability in a hedged item's functional-currency-equivalent cash flows are eliminated by the effect of the hedge:

- a. Difference in optionality (Case A)
- b. Difference in reset dates (Case B)
- c. Difference in notional amounts (Case C).

> > > Case A: Difference in Optionality

815-20-55-133 An entity has issued a fixed-rate foreign-currency-denominated debt obligation that is callable (that is, by that entity) and desires to hedge its foreign currency exposure related to that obligation with a fixed-to-fixed cross-currency swap. A fixed-to-fixed currency swap could be used to hedge the fixed-rate foreign-currency-denominated debt instrument that is callable even though the swap does not contain a mirror-image call option as long as the terms of the swap and the debt instrument are such that they would be highly effective at providing offsetting cash flows and as long as it was probable that the debt instrument would not be called and would remain outstanding.

> > > Case B: Difference in Reset Dates

815-20-55-134 An entity has issued a variable-rate foreign-currency-denominated debt obligation and desires to hedge its foreign currency exposure related to that obligation. The entity uses a variable-to-fixed cross-currency interest rate swap in which it receives the same foreign currency based on the variable rate index contained in the debt obligation and pays a fixed amount in its functional currency. If the swap would otherwise meet this Subtopic's definition of providing high effectiveness in hedging the foreign currency exposure of the debt instrument, but there is a one day difference between the reset dates in the debt obligation and the swap (that is, the one day difference in reset dates results in the hedge being highly effective, but not perfectly effective), the variable-to-fixed cross-currency interest rate swap could be used to hedge the variable-rate foreign-currency-denominated debt instrument even though there is a one-day difference between the reset dates or a slight difference in the notional amounts in the debt instrument and the swap. This would be true as long as the difference in reset dates or notional amounts is not significant enough to cause the hedge to fail to be highly effective at providing offsetting cash flows.

> > > Case C: Difference in Notional Amounts

815-20-55-135 This Case involves the same facts as in Case B, except that there is no difference in the reset dates. However, there is a slight difference in the notional amount of the swap and the hedged item. If the swap would otherwise meet this Subtopic's definition of providing high effectiveness in hedging the foreign currency exposure of the debt instrument, paragraph 815-20-25-39(d) does not preclude the swap from qualifying for hedge accounting simply because the notional amounts do not exactly match. The mismatch ~~ineffectiveness~~ attributable to the slight difference in the notional amount of the swap and the hedged item could be eliminated by designating only a portion of the contract with the larger notional amount as either the hedging instrument or hedged item, as appropriate.

> > Example 14: Hedging a Firm Commitment or Fixed-Price Agreement Denominated in a Foreign Currency

815-20-55-136 The following Cases illustrate hedging foreign exchange risk under the cash flow hedging model as discussed in paragraph 815-20-25-42 and others:

- a. Firm commitment (Case A)
- b. Fixed-price agreement (Case B).

> > > Case A: Firm Commitment

815-20-55-137 On January 1, an entity enters into an agreement to sell 1,000 tons of a nonfinancial asset to an unrelated party on June 30. The agreement meets the definition of a firm commitment. The firm commitment is denominated in the buyer's functional currency, which is not the seller's functional currency. Accordingly, the firm commitment exposes the seller to foreign currency risk. The seller may hedge the foreign currency exposure arising from the firm commitment under the fair value hedging model.

815-20-55-138 The seller may hedge its exposure to foreign currency risk under the cash flow hedging model even though the agreement meets the definition of a firm commitment. Accordingly, the seller may hedge the foreign currency exposure arising from the firm commitment to sell 1,000 tons of the nonfinancial asset under the cash flow hedging model, even though the seller has previously hedged its foreign currency exposure arising from another similar firm commitment under the fair value hedging model.

> > > Case B: Fixed-Price Agreement

815-20-55-139 On January 1, an entity enters into an agreement to sell 1,000 tons of a nonfinancial asset to an unrelated party on June 30. Although the agreement

in this Case does not meet the definition of a firm commitment, the seller's assessment of the observable facts and circumstances is that performance under the agreement is probable. The agreement is denominated in the buyer's functional currency, which is not seller's functional currency. Accordingly, the foreign-currency-denominated fixed-price agreement exposes the seller to foreign currency risk.

815-20-55-140 If the agreement does not meet the definition of a firm commitment, but contains a fixed foreign-currency-denominated price, the seller may not hedge the foreign currency risk relating to the agreement to sell the nonfinancial asset under the fair value hedging model because the agreement is not a recognized asset, a recognized liability, or a firm commitment, which are the only items that can be designated as the hedged item in a fair value hedge. However, the seller may hedge the foreign currency risk relating to the agreement under the cash flow hedging model. The agreement is by definition a forecasted transaction because the sale of the nonfinancial assets will occur at the prevailing market price, that is, the fixed foreign-currency-denominated market price converted into the seller's functional currency at the prevailing exchange rate when the transaction occurs. Therefore, because the agreement includes a fixed foreign-currency-denominated price, the agreement exposes the seller to variability in the functional-currency-equivalent cash flows. Accordingly, the seller may not hedge the foreign currency risk relating to the agreement to sell 1,000 tons of the nonfinancial asset under the fair value hedging model but may hedge the foreign currency risk under the cash flow hedging model.

> > Example 15: Portions of a Foreign-Currency-Denominated Financial Asset or Liability as Hedged Item

815-20-55-141 The following Cases illustrate the application of paragraph 815-20-25-41 to fixed-rate and variable-rate foreign-currency-denominated debt:

- a. Foreign-currency-denominated fixed-rate debt (Case A)
- b. Foreign-currency-denominated variable-rate debt (Case B).

815-20-55-142 Specifically, for each of the eight situations presented collectively in Cases A (see paragraph 815-20-55-143) and B (see paragraph 815-20-55-153), an entity can use cash flow hedge accounting to hedge the variability in the specific principal repayments, interest cash flows, or both by applying the guidance in paragraph 815-30-35-3(d) to the specifically identified hedged cash flows. Only an amount that would offset the transaction gain or loss arising from the remeasurement of a hedged cash flow would be reclassified each period from other comprehensive income to earnings. Also, the change in the fair value of the forward points (time value) attributable to the hedged future cash flows would be reported in other comprehensive income, while the change in the fair value of the forward points (time value) attributable to the unhedged future cash flows would be reported in earnings.

> > > Case A: Foreign-Currency-Denominated Fixed-Rate Debt

815-20-55-143 Entity ABC, a U.S. dollar (USD) functional entity, issues a five-year foreign-currency-denominated fixed-rate debt obligation that requires interest payments and partial principal payments annually in the foreign currency with the remaining principal due at the end of five years (maturity) in the foreign currency. More specifically, Entity ABC issues an FC 45 million debt obligation on December 31, 20X0, with FC 5 million due on December 31 of each of the next 4 years and FC 25 million due on December 31, 20X5. Interest payments at 10 percent are paid annually.

815-20-55-144 In this Case, Entity ABC can use cash flow hedge accounting to hedge the variability in its functional-currency-equivalent cash flows associated with any of the following:

- a. All of the payments of both principal and interest of the debt
- b. All of the payments of principal of the debt
- c. All or a fixed portion of selected payments of either principal or interest of the debt (such as either principal or interest payments on December 31, 2001, and December 31, 2003)
- d. Selected payments of both principal and interest of the debt (such as principal and interest payments on December 31, 2001, and December 31, 2003).

815-20-55-145 For instance, Entity ABC could use a receive-fixed-rate, pay-fixed-rate cross-currency interest rate swap or a series of forward contracts to eliminate variability attributable to foreign exchange rates.

815-20-55-146 The following illustrates the second option, hedging the variability in all principal cash flows attributable to foreign exchange risk.

815-20-55-147 Entity ABC enters into the following five forward contracts to hedge all principal cash flows:

- a. Forward contract to purchase FC 5,000 on December 31, 20X1, at a forward rate of 1.05061019
- b. Forward contract to purchase FC 5,000 on December 31, 20X2, at a forward rate of 1.06061601
- c. Forward contract to purchase FC 5,000 on December 31, 20X3, at a forward rate of 1.07066924
- d. Forward contract to purchase FC 5,000 on December 31, 20X4, at a forward rate of 1.08076989
- e. Forward contract to purchase FC 25,000 December 31, 20X5, at a forward rate of 1.090871.

815-20-55-148 Exchange rates are as follows.

Period	Spot	12/31/X1 Forward	12/31/X2 Forward	12/31/X3 Forward	12/31/X4 Forward	12/31/X5 Forward
12/31/X0	1.04060438	1.05061019	1.06061601	1.07066924	1.08076989	1.090871
12/31/X1	1.1		1.12125604	1.14271548	1.16448149	1.18655697
12/31/X2	1.1			1.12125604	1.14272548	1.16448149
12/31/X3	1.1				1.12125604	1.14272548
12/31/X4	1.1					1.12125604
12/31/X5	1.1					

815-20-55-149 Entity ABC would make the following journal entries.

	Debit (Credit)				
	Cash	Forward Contracts	Note Payable	Income or Expense	Accum. Other Comprehensive Income
Inception 12/31/X0	46,827		(46,827)		
December 31, 20X1 entries:					
Repayment of principal	(5,500)		5,203	297	
Payment of interest	(4,950)			4,950	
Transaction loss on note payable			(2,376)	2,376	
Fair value of forward contract #1		247			(247)
Settlement of forward #1	247	(247)			
Offset \$247 of loss on principal (\$50 related to cost of hedge remains in earnings)				(247)	247
Fair value of forward contracts #2–5 (based on 6% discount rate)		2,853			(2,853)
Paragraph 815-30-35-3(d) through (f) adjustment—offset the transaction loss related to principal				(1,734)	1,734
Paragraph 815-30-35-3(d) through (f) adjustment—effect of hedge				396	(396)
December 31, 20X2 entries:					
Repayment of principal	(5,500)		5,203	297	
Payment of interest	(4,400)			4,400	
Fair value of forward contract #2		(89)			89
Settlement of forward #2	197	(197)			
Offset \$197 of loss on principal (\$100 related to cost of hedge remains in earnings)				(197)	197
Fair value of forward contracts #3–5 (based on 6% discount rate)		(507)			507
Paragraph 815-30-35-3(d) through (f) adjustment—effect of hedge				299	(299)
Change in time value related to principal goes to other comprehensive income or change in time value related to interest goes to earnings ^(a)			297	(180)	(117)
December 31, 20X3 entries:					
Repayment of principal	(5,500)		5,203	297	
Payment of interest	(3,850)			(3,850)	
Fair value of forward contract #3		(92)			92
Settlement of forward #3	147	(147)			
Offset \$147 of loss on principal (\$150 related to cost of hedge remains in earnings)				(147)	147
Fair value of forward contracts #4–5 (based on 6% discount rate)		(477)			477
Paragraph 815-30-35-3(d) through (f) adjustment—effect of hedge				202	(202)
Change in time value related to principal goes to other comprehensive income or change in time value related to interest goes to earnings			297	(168)	(129)
December 31, 20X4 entries:					
Repayment of principal	(5,500)		5,203	297	
Payment of interest	(3,300)			3,300	
Fair value of forward contract #4		(95)			95
Settlement of forward #4	96	(96)			
Offset \$96 of loss on principal (\$201 related to cost of hedge remains in earnings)				(96)	96
Fair value of forward contract #5 (based on 6% discount rate)		(437)			437
Paragraph 815-30-35-3(d) through (f) adjustment—effect of hedge				104	(104)
Change in time value related to principal goes to other comprehensive income or change in time value related to interest goes to earnings			297	(154)	(143)
December 31, 20X5 entries:					
Repayment of principal	(27,500)		26,015	1,485	
Payment of interest	(2,750)			2,750	
Fair value of forward contract #5		(488)			488
Settlement of forward #5	228	(228)			
Offset \$228 of loss on principal				(228)	228
Paragraph 815-30-35-3(d) through (f) adjustment—effect of hedge			1,485	(1,001)	(484)
Change in time value related to principal goes to other comprehensive income or change in time value related to interest goes to earnings				(140)	140
	(21,008)	-	-	(b)	-

(a) The entry recording the \$297 gain for the period ended December 31, 20X2, results from the spot exchange rate remaining unchanged from December 31, 20X1, and one less period remaining on the loan payable. The \$117 principal portion of the gain goes to other comprehensive income because only principal is being hedged. The \$180 interest portion of the gain goes to earnings because interest is not being hedged.

(b) See Schedule 3 (paragraph 815-20-55-152) for income or expense for each period.

815-20-55-150 The following schedules support the preceding entries.

Schedule 1	Foreign Currency	Functional Currency at 12/31/X0 Spot Rate (1)	Functional Currency at Current Spot Rate (2)	Transaction Gain or Loss	(2) – (1)	Change in Time Value
12/31/X0						
Principal	30,976 ^(a)	32,234				
Interest	14,024 ^(a)	14,593				
Loan value	45,000	46,827				
12/31/X1						
Principal	29,192	30,377	32,111	1,734		
Interest	10,808	11,247	11,889	642		
Loan value	40,000	41,624	44,000			
12/31/X2						
Principal	27,222	28,328	29,945		1,617	117 = (1,734 – 1,617)
Interest	7,778	8,093	8,555		462	180 = (642 – 462)
Loan value	35,000	36,421	38,500			
12/31/X3						
Principal	25,048	26,065	27,553		1,488	129 = (1,617 – 1,488)
Interest	4,952	5,153	5,447		294	168 = (462 – 294)
Loan value	30,000	31,218	33,000			
12/31/X4						
Principal	22,649	23,568	24,913		1,345	143
Interest	2,351	2,447	2,586		140	154
Loan value	25,000	26,015	27,500			
12/31/X5 (before final principal payment is made)						
Principal	25,000	26,015	27,500		1,485	(140)
Interest	-	-	-			140
Loan value	25,000	26,015	27,500			

(a) The value ascribed to the principal portion was determined by discounting the future principal payments at an annual rate of 10% compounded quarterly. The value ascribed to the interest portion was determined by discounting future quarterly interest accruals at an annual rate of 10%.

815-20-55-151 Schedule 2 provides the amount of cost attributed to each period for each forward contract. Each period's cost is determined based on applying the interest method to each forward contract.

Schedule 2	Forward Contract #1	Forward Contract #2	Forward Contract #3	Forward Contract #4	Forward Contract #5	Total
12/31/X1	\$ 50.03	\$ 49.79	\$ 49.63	\$ 49.50	\$ 246.61	\$ 445.56
12/31/X2		50.27	50.11	49.97	248.95	399.30
12/31/X3			50.59	50.44	251.31	352.34
12/31/X4				50.92	253.69	304.61
12/31/X5					256.11	256.11
Total	\$ 50.03	\$ 100.06	\$ 150.33	\$ 200.83	\$ 1,256.67	\$ 1,757.92

815-20-55-152 Schedule 3 provides a breakdown for each year-end reporting period.

Schedule 3	
12/31/X1	
\$ 4,950	Interest expense
446	Cost of hedge (396 + (297 – 247))
642	Transaction loss related to unhedged interest (2,376 – 1,734)
<u>\$ 6,038</u>	<u>Total expense</u>
12/31/X2	
\$ 4,400	Interest expense
399	Cost of hedge (299 + (297 – 197))
(180)	Time value related to unhedged interest
<u>\$ 4,619</u>	<u>Total expense</u>
12/31/X3	
\$ 3,850	Interest expense
352	Cost of hedge (202 + (297 – 147))
(168)	Time value related to unhedged interest
<u>\$ 4,034</u>	<u>Total expense</u>
12/31/X4	
\$ 3,300	Interest expense
305	Cost of hedge (104 + (297 – 96))
(154)	Time value related to unhedged interest
<u>\$ 3,451</u>	<u>Total expense</u>
12/31/X5	
\$ 2,750	Interest expense
256	Cost of hedge (1,485 – (1,001 + 228))
(140)	Time value related to unhedged interest
<u>\$ 2,866</u>	<u>Total expense</u>

> > > Case B: Foreign-Currency-Denominated Variable-Rate Debt

815-20-55-153 Entity XYZ, a U.S. dollar (USD) functional entity issues a five-year foreign-currency-denominated variable-rate debt obligation that requires interest payments and partial principal payments annually in the foreign currency with the remaining principal due at the end of five years (maturity) in the foreign currency. More specifically, Entity XYZ issues an FC 45 million debt obligation on December 31, 20X0, with FC 5 million due on December 31 of each of the next 4 years and FC 25 million due on December 31, 20X5. Interest payments are paid annually based on LIBOR.

815-20-55-154 In this Case the guidance in paragraph 815-20-25-41 provides that Entity XYZ can use cash flow hedge accounting to hedge the variability in its functional-currency-equivalent cash flows associated with any the following:

- a. All of the payments of both principal and interest of the debt
- b. All of the payments of principal of the debt
- c. All or a fixed portion of selected payments of either principal or interest of the debt
- d. Selected payments of both principal and interest of the debt (such as principal and interest payments on December 31, 2001, and December 31, 2003).

815-20-55-155 An entity could use a receive-variable-rate, pay-fixed-rate cross-currency interest rate swap to eliminate variability attributable to interest rates and foreign exchange rates. In cash flow hedges of recognized foreign-currency-denominated assets and liabilities, the entity must assess whether the changes in cash flows attributable to the risk being hedged are expected to offset at the inception of the hedging relationship and on an ongoing basis. ~~As the hedging relationship does not qualify for the shortcut method, the entity must measure ineffectiveness.~~ In a manner similar to that described beginning in paragraph 815-30-35-25, the entity would assess the effectiveness ~~measure the ineffectiveness~~ of the hedge using the hypothetical derivative method. After the initial quantitative assessment of hedge effectiveness, the entity may elect to assess hedge effectiveness on a qualitative or quantitative basis.

> > Example 16: Oil-Linked Interest Rate Cap as Hedging Instrument

815-20-55-156 This Example illustrates whether an oil-linked interest rate cap can be designated in a qualifying hedging relationship.

815-20-55-157 Entity A enters into a complex option contract with multiple underlyings for which no net premium is received. The payoffs under the contract are nontraditional. Entity A wishes to designate the option in a cash flow hedging relationship. Specifically, Entity A is an oil producer with five-year variable-rate debt (indexed to three-month LIBOR) and is concerned that an environment of falling oil prices and rising interest rates could affect its ability to meet increasing interest payments on the variable-rate debt. To limit its exposure, Entity A enters into a five-year oil-linked interest rate cap with a notional amount equal to the principal amount of Entity A's three-month LIBOR-based variable-rate debt.

815-20-55-158 Under the terms of the oil-linked interest rate cap (a complex option), Entity A receives specified payments if both of the following conditions exist:

- a. 3-month LIBOR is greater than 7 percent
- b. The price of oil is less than \$25 per barrel.

815-20-55-159 Specifically, if both of the conditions in the preceding paragraph are met, Entity A receives payments under the oil-linked interest rate cap equal to the increased interest payments (that is, for floating-rate amounts above 7 percent) due on their floating-rate debt.

815-20-55-160 However, if the daily price of oil goes above \$25 per barrel at any time during a quarter, the option is knocked out for only that specific quarter. The option's knock-out feature is reset each quarter such that the interest rate coverage is knocked out for a specific quarter only if the daily price of oil goes above \$25 per barrel at any time during that specific quarter. Thus, the option limits Entity A's exposure to increases in interest rates for all quarters in which oil prices remain under \$25 per barrel throughout the quarter.

815-20-55-161 The oil-linked interest rate cap cannot be designated in a hedge of the variability in the difference between interest payments and sales proceeds on oil. The oil-linked interest rate cap purchased by Entity A is attempting to hedge Entity A's exposure to variability in the net cash flows related to certain revenue inflows and certain expense outflows. Entity A wishes to reduce the risk that an increase in cash outflows due to increases in interest rates will occur without a concurrent increase in cash inflows due to increases in the price of oil per barrel. Those are separate and dissimilar risks that Entity A wishes to hedge with a single derivative instrument. Thus, the hedged forecasted transaction cannot be a group of oil sales inflows and interest payment outflows. This Subtopic is not structured to permit hedge accounting for strategies involving hedges of a spread between revenues and expenses as Entity A is attempting to accomplish.

815-20-55-162 The oil-linked interest rate cap cannot be designated in a hedge of the variability in interest cash flows attributable to changes in LIBOR above 7 percent. Entity A could not simply define its hedged risk as the risk of changes in cash flows attributable to changes in the three-month LIBOR rate for only those periods when the price of oil per barrel is below a specified dollar amount.

815-20-55-163 If Entity A wanted to designate the oil-linked interest rate cap as a cash flow hedge of the variability in interest payments on the LIBOR-based variable-rate debt due to changes in interest rates above the contractually specified 7 percent rate in the interest rate cap, Entity A would be required to assess effectiveness whenever interest rates were above that 7 percent rate. Because the cap also has an underlying related to oil prices, there could be times when interest rates will be above the contractually specified interest rate in the cap but the complex option will not result in any cash flows because the selling price of oil is not below the contractually specified price per barrel (\$25). In other words, the complex option will be out of the money but Entity A will be required to assess the option's effectiveness in offsetting the increase in interest payments for the effect of the excess of 3-month LIBOR over 7 percent.

815-20-55-164 Generally, it would be unlikely that Entity A could conclude that the oil-linked interest rate cap is expected to be highly effective in achieving offsetting cash flows if it is reasonably possible that the oil-linked option will knock out the cash inflows from the derivative instrument. In its assessment of the effectiveness of the hedge of the interest payments on the variable-rate debt, Entity A must consider the likelihood that the interest-rate protection from the oil-linked interest rate cap may be knocked out due to oil prices exceeding the contractually specified amount per barrel and it may not exclude from its assessment of effectiveness those periods when the interest rate protection is knocked out. For those quarters when the cap is knocked out, there are no cash flows from the cap to be used to offset the change in the cash flows on the hedged forecasted transaction.

815-20-55-165 In the unlikely event that Entity A was able to conclude that the relationship was expected to be highly effective (because the complex option was expected to be highly effective for all changes in the three-month LIBOR rate above the contractually specified rate due to the remoteness that the price of oil per barrel would not be below the contractually specified amount over the contractual life of the debt), the complex option could be used as the hedging derivative.

815-20-55-166 The oil-linked interest rate cap cannot be designated in a hedge of the variability in proceeds from the forecasted sale of oil. If Entity A wanted to designate the oil-linked interest rate cap as a cash flow hedge of the risk of overall changes in the sales proceeds from the forecasted sale of oil below the contractually specified price per barrel in the interest rate cap, the hedging relationship would fail to qualify under paragraph 815-20-25-75(b) because the cash inflows from the oil-linked interest rate cap are calculated based on the debt's principal amount and the excess of 3-month LIBOR over 7 percent. Because the cash inflows from the oil-linked interest rate cap are unrelated to the proceeds from oil sales, Entity A could not expect the proposed hedging relationship to be highly effective at achieving offsetting cash flows.

> > Example 17: Designation of an Intra-Entity Loan or Other Payable as the Hedging Instrument in a Fair Value Hedge of an Unrecognized Firm Commitment

815-20-55-167 This Example illustrates the application of paragraph 815-20-25-60.

815-20-55-168 A parent entity (Parent A) with the U.S. dollar (USD) as both its functional currency and reporting currency has a subsidiary with a Euro (EUR) functional currency (Subsidiary B). Subsidiary B enters into an unrecognized firm commitment with a third party that will result in Japanese yen (JPY) cash inflows. Concurrent with Subsidiary B entering into the firmly committed contract, Parent A extends a loan to Subsidiary B denominated in JPY, which is funded by a third-

party, JPY-denominated borrowing by Parent A. Subsidiary B wishes to designate its JPY-denominated intra-entity loan payable as the hedging instrument in consolidated financial statements in a fair value hedge of foreign currency exposure related to its JPY-denominated unrecognized firm commitment to a third party.

815-20-55-169 In accordance with paragraph 830-20-35-1, at each balance sheet date, Subsidiary B's JPY-denominated intra-entity loan payable would be remeasured from the foreign currency (JPY) into Subsidiary B's functional currency (EUR) at the current EUR/JPY spot rate. Similarly, Parent A's intra-entity JPY-denominated receivable and its third-party JPY-denominated loan payable are remeasured from the foreign currency (JPY) into Parent A's functional currency (USD) at the current USD/JPY spot rate. The transaction gains or losses that are generated from remeasurement into functional currency are recorded in net income. If Subsidiary B designates its JPY-denominated intra-entity loan payable as the hedging instrument in consolidated financial statements, the transaction gains and losses related to the intra-entity loan payable would offset the change in fair value of the firm commitment attributable to changes in foreign exchange rates in the consolidated income statement.

815-20-55-170 In this Example, Subsidiary B's JPY-denominated intra-entity payable may be designated as a fair value hedge of the foreign exchange exposure arising from the third-party JPY-denominated firm commitment. Parent A has in place a third-party JPY-denominated borrowing that offsets the exposure of its JPY-denominated intra-entity receivable from Subsidiary B during the period the intra-entity loan receives hedge accounting.

> > **Example 18: Offsetting a Subsidiary's Exposure on a Net Basis**

815-20-55-171 This Example illustrates the application of paragraph 815-20-25-61(b)(2) in offsetting a subsidiary's exposure on a net basis in which neither leg of the third-party position is in the treasury center's functional currency.

815-20-55-172 If a U.S. dollar (USD) functional currency treasury center was short 390 Euros (EUR) and long 40,684.80 yen (JPY) after netting its exposures obtained from **internal derivatives** and the forward exchange rate between EUR and JPY was EUR 1.00 = JPY 104.32, then the treasury center could enter into a third-party receive EUR 390, pay JPY 40,684.80 contract to offset the exposures. In contrast, if the treasury center was short EUR 390 and long JPY 51,000, then the treasury center would need to enter into 2 third-party contracts with the receive leg of the second third-party position being the treasury center's functional currency. For example, the treasury center could enter into a third-party receive EUR 390, pay JPY 40,684.80 contract to offset the EUR exposure and partially offset the JPY exposure. It would then need to enter into a receive functional currency, pay JPY contract to hedge the remainder of its JPY exposure.

> > Example 19: Hedging a Portfolio of Fixed-Rate Financial Assets

815-20-55-173 This Example illustrates the application of paragraphs 815-20-25-12(b)(1) and 815-20-25-75 to a hedge of a portfolio of fixed-rate financial assets.

815-20-55-174 Entity A has a portfolio of seasoned, one to four family, fixed-rate mortgages that it wishes to designate as the hedged item in a fair value hedge of the benchmark interest rate (LIBOR). Each loan within the portfolio has similar settlement terms, is collateralized by property in the same geographic region, and has similar scheduled maturities. The loans are all within a specified interest rate band and are prepayable at par; each of the loans contained in the portfolio is expected to react in a generally proportionate manner to changes in the benchmark interest rate based on calculations performed by Entity A.

815-20-55-175 Entity A enters into a pay-fixed, receive-LIBOR interest rate swap with a fair value of zero at the inception of the hedging relationship. The stated maturity of the interest rate swap is consistent with the stated maturities of the loans. The notional amount of the interest rate swap amortizes based on a schedule that is expected to approximate the principal repayments of the loans (excluding prepayments). There is no optionality included in the interest rate swap. As part of its documented risk management strategy associated with this hedging relationship, on a quarterly basis, Entity A intends to do both of the following:

- a. Assess effectiveness of the existing hedging relationship on a quantitative basis for the past three-month period
- b. Consider possible changes in value of the hedging derivative and the hedged item over the next three months in deciding whether it has an expectation that the hedging relationship will continue to be highly effective at achieving offsetting changes in fair value.

815-20-55-176 Entity A's portfolio of loans satisfies the requirements of paragraph 815-20-25-12(b)(1) regarding the grouping of similar assets because the portfolio of loans has been defined in a restrictive manner and Entity A determined, by calculation, that each of the loans contained in the portfolio is expected to react in a generally proportionate manner to changes in the benchmark interest rate. Even though certain of the loans may prepay, each loan still may be considered to have the same exposure to prepayment risk because each loan has a similar prepayment option. When aggregating loans in a portfolio, an entity is permitted to consider among other things prepayment history of the loans (if seasoned) and expected prepayment performance in varying interest rate scenarios.

815-20-55-177 Entity A's documented hedging strategy meets the requirements of paragraph 815-20-25-75 for a prospective assessment of effectiveness provided the entity established that the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated.

815-20-55-178 Paragraph 815-20-25-79(a) explains that a probable future change in fair value will be more heavily weighted than a reasonably possible future change. For example, Entity A could assign a probability weighting to each possible future change in value of the hedged portfolio. Depending on the level of market interest rates and the expected prepayment rates for the types of loans in the hedged portfolio, Entity A may reach a conclusion that the change in fair value of the swap will be highly effective at offsetting the change in the value of the portfolio of loans, inclusive of the prepayment option. As a result of this analysis, management would conclude that hedge accounting is permitted for the hedging relationship for the next three-month ~~period, period; however, any ineffectiveness related to the current period must be reflected currently in earnings.~~ (That is, ~~management~~ Management is required to assess the effectiveness of the existing hedging relationship for the past three-month period.) ~~The amount of ineffectiveness related to the current period will be the difference between the change in fair value of the swap (which could have a notional amount different than the hedged portfolio) and the change in fair value of the existing hedged portfolio. If necessary, the notional amount of the swap in excess of the portfolio balance at the end of each three-month period must be dedesignated and a new hedging relationship designated (with a smaller percentage of the swap as the hedging instrument) going forward to allow high effectiveness to continue in the future.~~

> > **Example 20: Combinations of Options in Which Strike Prices or Notional Amounts Do Not Remain Constant**

815-20-55-179 The following Cases illustrate the application of paragraph 815-20-25-91 to combinations of options in which either the strike price or the notional amount in either the written option component or the purchased option component can fluctuate over the life of the respective component:

- a. Changes in strike prices (Case A)
- b. Changes in notional amounts (Case B).

815-20-55-180 Cases A and B share the following assumptions:

- a. An entity wishes to hedge its forecasted sales of a commodity by entering into a five-year commodity-price collar.
- b. Under the collar, the entity will do both of the following:
 - 1. Purchase commodity-price put option components (a floor)
 - 2. Write commodity-price call option components (a cap).
- c. Each of the alternative collars discussed otherwise meets the criteria established in paragraphs 815-20-25-89 through 25-90 including all of the following:
 - 1. No net premium is received at inception of the combination of options. Paragraph 815-20-25-94 addresses, in part, whether a net premium is received at any point during the life of the combination of options that the strike price or notional amount is changed.

2. The components of the combination of options are based on the same underlying (that is, the same commodity price).
3. The components of the combination of options have the same maturity date.
4. The notional amount of the written option component is not greater than the notional amount of the purchased option component. Paragraph 815-20-25-94 addresses, in part, whether this criterion should be applied to only the entire contractual term to maturity or to some part thereof.

> > > Case A: Changes in Strike Prices

815-20-55-181 The following table presents both of the following:

- a. Commodity prices implied by the forward price curve based on market prices
- b. The strike prices of two alternative collars.

The minimum prices for each collar represent the strike prices of the purchased put options. The maximum prices for each collar represent the strike prices of the written call options. (Assume that the notional amounts of the two option components are identical and constant over the life of the option components.)

<i>(Cents Per Unit)</i>	20X2	20X3	20X4	20X5	20X6	5-Year Average
Forward price	100.0	103.9	105.6	106.4	106.7	104.5
Collar 1						
Minimum	98.3	98.3	98.3	98.3	98.3	98.3
Maximum	110.6	110.6	110.6	110.6	110.6	110.6
Collar 2						
Minimum	108.5	108.5	91.5	91.5	91.5	98.3
Maximum	108.5	108.5	108.5	110.4	117.2	110.6

815-20-55-182 Note that the 5-year averages of the minimum prices (98.3 cents) and the maximum prices (110.6 cents) of the 2 collars are identical and are consistent with the 5-year average implied by the forward price curve. (That is, 104.5 cents equals the average of the 98.3-cent minimum strike price and the 110.6-cent maximum strike price.) No net premium is received at inception for either collar taking into consideration the entire contractual term of the combination of options from inception to maturity.

815-20-55-183 For Collar 2, premiums are received in early periods as consideration for entering into net written options in later periods. Specifically, the (higher-than-average) strike prices in years 20X2 and 20X3 are received (that is, receipt of a net premium) in return for accepting less favorable (lower-than-average) strike prices in years 20X4 through 20X6 (that is, net written options).

Thus, at the inception of the hedge and over its life, Collar 2 would be subject to the provisions of paragraph 815-20-25-94.

> > > Case B: Changes in Notional Amounts

815-20-55-184 The following table presents the notional amounts of two alternative collars. (Assume that the strike prices of the two collars are identical and constant over the life of the collars.)

<i>(Notional Units)</i>	<u>20X2</u>	<u>20X3</u>	<u>20X4</u>	<u>20X5</u>	<u>20X6</u>	<u>Total Notional Amount</u>	<u>5-Year Average</u>
Collar 3							
Minimum	750	750	750	750	750	3,750	750
Maximum	750	750	750	750	750	3,750	750
Collar 4							
Minimum	1,240	1,240	1,240	15	15	3,750	750
Maximum	250	250	250	1,500	1,500	3,750	750

815-20-55-185 Note that both the sum and average of the notional amounts of the written option component for all periods are not greater than the sum and average of the notional amounts of the purchased option component for all periods.

815-20-55-186 For Collar 4, favorable terms are received in early periods (net purchased options) as consideration for entering into net written options in later periods. Specifically, the (higher-than-average) notional amounts on the purchased put option in years 20X2 through 20X4 are received in return for accepting a less favorable notional amount in years 20X5 and 20X6. Thus, at the inception of the hedge and over its life, Collar 4 in Case B would be subject to the provisions of paragraph 815-20-25-94.

815-20-55-187 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-188 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-189 Paragraph superseded by Accounting Standards No. Update No. 2016-01.

815-20-55-190 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-191 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-20-55-192 Paragraph superseded by Accounting Standards Update No. 2016-01.

> > Example 22: Designation If Hedged Exposure Is Limited but Derivative Instrument Exposure Is Not

815-20-55-193 The following Cases illustrate the application of paragraph 815-20-25-100 to situations in which the hedged item or hedged forecasted transaction may have a risk exposure that is limited, but the derivative instrument that the entity desires to designate as a hedging instrument does not have comparable limits:

- a. Fair value hedge (Case A)
- b. Cash flow hedge (Case B).

815-20-55-194 For the purposes of both Cases A and B, it is assumed that the shortcut method may not be applied.

> > > Case A: Fair Value Hedge

815-20-55-195 Entity A issues 10-year fixed-rate debt that is callable at the end of the fifth year. It decides to convert the interest payments on the bond from fixed-rate to variable-rate by entering into a 10-year receive-fixed, pay-variable interest rate swap. The interest rate swap is not cancelable at the end of the fifth year. From Entity A's perspective, if interest rates increase, there is a gain on the debt (the liability's fair value decreases) and a loss on the swap (fair value either decreases as an asset or increases as a liability). If interest rates decrease, there is a loss on the debt (the liability's fair value increases) and a gain on the swap (fair value either increases as an asset or decreases as a liability). However, during the first five years, if interest rates decrease, the gain on the swap will exceed the loss on the debt because the debt's fair value change will consider the impact of the call feature, which is in the money when interest rates fall below the stated rate on the debt. Entity A wishes to designate the interest rate swap as the hedging instrument in a fair value hedge of interest rate risk of the fixed-rate debt. The conclusions for Case A and Case B are discussed in paragraph 815-20-55-197.

> > > Case B: Cash Flow Hedge

815-20-55-196 Entity B issues 10-year, variable-rate debt that reprices based on 6-month LIBOR. The interest rate on the debt is capped at 9 percent. Entity B decides to convert the interest payments on the debt from variable-rate to fixed-rate by entering into a receive-variable, pay-fixed interest rate swap. There is no cap on the variable-rate leg of the interest rate swap. From Entity B's perspective, if interest rates decrease, there will be a cumulative reduction in the expected future cash outflows on the debt and a cumulative reduction in the expected future cash inflows on the swap. If interest rates increase, there will be a cumulative increase in the expected future cash outflows on the debt and a cumulative increase in the expected future cash inflows on the swap. However, if interest rates increase such that the variable rate on the swap would be greater than 9 percent,

the cumulative increase in the expected future cash inflows on the swap will exceed the cumulative increase in the expected future cash outflows on the debt because of the interest rate cap on the debt, which is in the money if interest rates increase such that the variable rate on the debt would exceed 9 percent. Entity B wishes to designate the interest rate swap as the hedging instrument in a cash flow hedge of interest rate risk of the variable-rate debt.

> > Analysis

815-20-55-197 In both Cases A and B, the entity must assess, based on an appropriate methodology, whether the changes in fair value or cash flows of the interest rate swap could be expected to be highly effective in offsetting changes in fair value or cash flows of the debt attributable to interest rate risk taking into account the ~~impact~~ effect of the embedded call option (Case A) or the ~~impact~~ effect of the interest rate cap (Case B). As required by paragraph 815-20-25-6 ~~815-20-25-12(f)~~, the effect of an embedded derivative of the same risk class must be considered in designating a hedge of an individual risk. Therefore, if the options in Cases A and B are expected to be out of the money based on a probability-weighted analysis of the range of possible changes in interest rates, then those options would be expected to have a minimal ~~impact~~ effect on changes in fair value or cash flows of the debt, and the hedging relationships could meet the requirement for an expectation of high effectiveness. In the case of a fair value hedge of callable debt discussed in Case A, in accordance with paragraph 815-20-25-6B, Entity A may assess hedge effectiveness on the basis of whether the debt will be called at the end of the fifth year because of expected changes in benchmark interest rates, but not because of other factors potentially affecting the exercise of the call feature. Entity A intends to assess hedge effectiveness on this basis.

815-20-55-198 Paragraph superseded by Accounting Standards Update No. 2016-02.

> > Example 24: No Continuation of the Shortcut Method Following a Purchase Business Combination

815-20-55-199 This Example addresses whether the shortcut method in paragraph 815-20-25-102 can be applied in the circumstances illustrated. This Example has the following assumptions:

- a. Entity A acquires Entity B in a business combination. A business combination is accounted for as the acquisition of one entity by another entity. The acquiring entity, Entity A, records the assets acquired and liabilities assumed at fair value.

- b. Subparagraph superseded by Accounting Standards Update No. 2017-12. Entity A and Entity B both have adopted the Derivatives and Hedging Topic before the date of the business combination.
- c. At the date of the business combination, Entity A and Entity B both have certain hedging relationships that have met the requirements as discussed beginning in paragraph 815-20-25-102 and that are being accounted for by the respective entities under the shortcut method of accounting.
- d. At the date of the business combination, the fair value of the hedging swaps in Entity B's hedging relationships is other than zero.

815-20-55-200 Unless the applicable hedging relationships meet the requirements in paragraph 815-20-25-102 at the date of the business combination (which would be highly unlikely because the swap's fair value would rarely be zero at that date) and the combined entity chooses to designate the swaps and the hedged items as hedging relationships to be accounted for under the shortcut method, the acquirer cannot continue to use the shortcut method of accounting for the hedging relationships of the acquiree that were being accounted for by the acquiree under the shortcut method of accounting at the date of the business combination.

815-20-55-201 Entity A is acquiring the individual assets and liabilities of Entity B at the date of the business combination and accordingly any preexisting hedging relationships of old Entity B must be designated anew by the combined entity at the date of the business combination in accordance with the relevant requirements of this Subtopic.

815-20-55-202 In part, this Example entails a determination of whether the business combination results in a new inception date for the combined entity for hedging relationships entered into by the acquiree before the consummation of the business combination that remain ongoing at the date of the business combination. The concept of acquisition accounting follows the accounting for acquisitions of individual assets and liabilities. That is, the combined entity should account for the assets and liabilities acquired in the business combination consistent with how it would be required to account for those assets and liabilities if they were acquired individually in separate transactions. The acquisition method is based on the premise that in an acquisition, the acquired entity (Entity B) ceases to exist and only the acquiring entity (Entity A) survives. Thus, the postacquisition hedging relationship designated by Entity A is a new relationship that has a new inception date.

815-20-55-203 Even in the unlikely circumstance that the new hedging relationship qualifies for the shortcut method, there would be no continuation of the shortcut method of accounting that had been applied by the acquired entity.

> > Example 25: Hedge Effectiveness Horizon in a Fair Value Hedge When Effectiveness Is Assessed on a Quantitative Basis

815-20-55-204 This Example illustrates the application of paragraph 815-20-25-118. Under the guidance in that paragraph, if a derivative instrument with a five-year term is designated as the hedging instrument in a fair value hedge of a financial asset that also has a five-year term, an entity may base its expectation that the hedging relationship will be highly effective in achieving offsetting changes in fair value for the risk being hedged by considering the possible changes in value occurring only over a shorter period than the life of the derivative instrument, such as over only the first three months of the derivative instrument's five-year life. For example, an entity may specify, in documenting its risk management strategy, that every three months it will do both of the following:

- a. It will assess the effectiveness of the existing hedging relationship for the past three-month period.
- b. It intends to consider possible changes in value of the hedging derivative and the hedged item over the next three months in deciding whether it has an expectation that the hedging relationship will continue to be highly effective at achieving offsetting changes in fair value.

> > Example 26: Defining the Risk Exposure for Hedging Relationships Involving an Option Contract as the Hedging Instrument

815-20-55-205 This Example illustrates the application of paragraph 815-20-25-124.

815-20-55-206 Entity XYZ, a U.S. dollar (USD) functional currency entity forecasts the purchase of goods with the payment denominated in pounds sterling (GBP). To hedge the foreign currency exposure from the forecasted purchase, Entity XYZ purchases an at-the-money call option on GBP. The notional amount of the option equals the forecasted value of goods to be purchased, and the option exercise date is the date the purchase consummates. At inception of the hedging relationship the strike price and the forward market exchange rate for GBP 1 are both USD 1.50. The time value component on the option is USD 0.15 per GBP. The foreign currency option in this Example could be effective as a hedging instrument only if effectiveness for that hedging relationship were based solely on either of the following:

- a. Changes in the option's intrinsic value
- b. Changes in the option's entire fair value.

815-20-55-207 As stated in paragraph 815-20-25-124, it is inappropriate to assert that only limited risk exposures are being hedged, such as exposures related only to currency-exchange-rate changes above USD 1.65 per GBP.

> > Example 27: Purchased Option Used in a Cash Flow Hedge

815-20-55-208 This Example illustrates the application of paragraph 815-20-25-126.

815-20-55-209 An entity forecasts that 1 year later it will purchase 1,000 ounces of gold at then current market prices for use in its operations. The entity wishes to protect itself against increases in the cost of gold above the current market price of \$275 per ounce. The entity purchases a 1-year cash-settled at-the-money gold option on 1,000 ounces of gold, paying a premium of \$10,000. If the price of gold is above \$275 at the maturity (settlement) date, the counterparty will pay the entity 1,000 times the difference. If the price of gold is \$275 or below at the maturity date, the contract expires worthless. The option cannot be exercised before its contractual maturity date. The entity designates the purchased option contract as a hedge of the variability in the purchase price (cash outflow) of the 1,000 ounces of gold for prices above \$275 per ounce.

815-20-55-210 In assessing the effectiveness of the cash flow hedge, the entity would determine that because the change in the expected future pay-off amount of the purchased option completely offsets the change in the expected future cash flows on the purchase of 1,000 ounces of gold above \$275 per ounce, the hedging relationship is expected to be highly effective under paragraph 815-20-25-75(b).

815-20-55-211 The entity would conclude there is perfect effectiveness ~~no ineffectiveness to be recognized in earnings in this Example~~ because all of the following conditions exist:

- a. All the critical terms of the hedging derivative completely match the hedged forecasted transaction.
- b. The strike price of the hedging instrument matches the specified level (\$275) beyond which the entity's exposure is being hedged.
- c. The hedging derivative's inflows at expiration completely offset the hedged transaction's outflows for any increase in the price of gold above \$275 per ounce.
- d. The hedging option cannot be exercised before its contractual maturity date.

> > Example 28: Effectiveness of a Combination of Options Involving One Written Option and Two Purchased Options

815-20-55-212 This Example illustrates the application of paragraph 815-20-25-131.

815-20-55-213 Entity JPN is a Japanese subsidiary of a U.S. entity. Entity JPN's functional currency is the Japanese yen (JPY). Entity JPN has forecasted inventory

purchases to be paid in U.S. dollars (USD). As a result, Entity JPN is exposed to changes in the JPY-USD exchange rate: its functional currency cash outflows will increase (loss) if JPY weakens versus USD and decrease (gain) if JPY strengthens versus USD.

815-20-55-214 Entity JPN would like to hedge the foreign currency exposure related to the forecasted transaction by entering into a combination of foreign-currency-denominated option contracts designated as a single hedging instrument.

815-20-55-215 For purposes of this discussion, assume all of the following:

- a. Entity JPN has met the qualifying criteria regarding forecasted transactions eligible for designation as hedged transactions pursuant to paragraph 815-20-25-15 and the options are entered into contemporaneously with the same counterparty and can be transferred independently of each other.
- b. The combination of foreign currency option contracts meets all of the conditions in paragraphs 815-20-25-89 through 25-90 to be considered a net purchased option (that is, considered not to be a net written option subject to the requirements of paragraph 815-20-25-94).

815-20-55-216 Entity JPN employs the following hedging strategy:

- a. The forecasted transaction is estimated at USD 150,000,000. The at-the-money forward rate is JPY 120 per USD 1.
- b. Entity JPN's documented hedge objective is to offset the foreign exchange risk to the functional currency equivalent cash flows at levels above JPY 125/USD 1 and in the range from JPY 113/USD 1 to JPY 108/USD 1. In the range JPY 113/USD 1 to JPY 125/USD 1 and at levels below JPY 108/USD 1, Entity JPN chooses not to offset the foreign exchange risk to the functional currency equivalent cash flows.
- c. To implement this hedge objective, Entity JPN enters into all three of the following option contracts and jointly designates them as the hedging instrument:
 1. Option 1. One purchased option that gives Entity JPN the right to purchase USD 150,000,000 at an exchange rate of JPY 125/USD 1. Premium paid: USD 1,536,885.
 2. Option 2. One sold (written) option that, if exercised, obligates Entity JPN to purchase USD 150,000,000 at an exchange rate of JPY 113/USD 1. Premium received: USD 1,536,885.
 3. Option 3. One purchased option that gives Entity JPN the right to sell USD 150,000,000 at an exchange rate of JPY 108/USD 1. Premium paid: USD 737,705.

815-20-55-217 The time value of the combination of options is to be excluded from the assessment of effectiveness and, therefore, effectiveness is based only on changes in intrinsic value related to the combination of options.

815-20-55-218 The purpose of Option 1 is to protect Entity JPN when the JPY-USD exchange rate increases above JPY 125/USD 1. As the JPY-USD exchange rate increases, Entity JPN will be required to purchase the USD 150,000,000 inventory at a greater JPY-equivalent cost. As the JPY-USD exchange rate increases above JPY 125/USD 1, the intrinsic value of the option increases as the option is increasingly in the money. That increase in the option's intrinsic value is expected to offset the increase in the JPY-equivalent expenditure on the forecasted transaction.

815-20-55-219 Entity JPN also writes an option (Option 2) that obligates Entity JPN to purchase USD from the counterparty at an exchange rate of JPY 113/USD 1. The counterparty will exercise the option whenever the JPY-USD exchange rate is below JPY 113/USD 1. As the JPY-USD exchange rate decreases, Entity JPN will be required to purchase the USD 150,000,000 inventory at a lesser JPY-equivalent cost. As the JPY-USD exchange rate decreases below JPY 113/USD 1, Entity JPN's losses related to increases in the intrinsic value of the written option are expected to offset the decrease in the JPY-equivalent expenditure on the forecasted transaction.

815-20-55-220 Entity JPN also purchases an option to sell USD (Option 3) for a notional amount equal to the notional of the written option (Option 2) with a strike price of JPY 108/USD 1. Entity JPN will exercise Option 3 whenever the JPY-USD exchange rate is below JPY 108/USD 1. When the exchange rate is below JPY 108/USD 1, although Entity JPN will be obligated to make a payment in relation to Option 2, it will also receive a payment in relation to Option 3. As a result of purchasing Option 3, Entity JPN will be exposed to exchange rate fluctuations on Option 2 only when the exchange rate is between JPY 113/USD 1 and JPY 108/USD 1. Hence, with Options 2 and 3, Entity JPN has effectively limited its hedge offset to changes in cash flows on the forecasted item to levels between JPY 113/USD 1 and JPY 108/USD 1. Changes in the exchange rate below JPY 108/USD 1 result in no change in the intrinsic value of the combination of options because the change in Option 2 offsets the change in Option 3. However, when the exchange rate is below JPY 108/USD 1, the combination of options has an intrinsic value other than zero.

815-20-55-221 In summary, potential changes in intrinsic value related to this combination option hedge construct (Options 1, 2, and 3) would limit the hedge offset to corresponding changes in functional currency cash flows on the forecasted transaction only at levels above JPY 125/USD 1 and in the range JPY 108/USD 1 to JPY 113/USD 1, consistent with Entity JPN's documented hedge objective.

815-20-55-222 The cash flow hedging relationship in this Example involving a combination of options may be considered effective at offsetting the change in cash flows due to foreign currency exchange rate movements related to the forecasted transaction. Specifically, Entity JPN may assess the effectiveness of the hedge based only on changes in the underlying that cause a change in the intrinsic value of the combination of options. Thus, in that case, Entity JPN would assess effectiveness of the hedge only when the JPY-USD exchange rate is above JPY 125/USD 1 and between JPY 113/USD 1 and JPY 108/USD 1. Likewise, Entity JPN's assessment would exclude changes in the JPY-USD exchange rate between JPY 113/USD 1 and JPY 125/USD 1 and below JPY 108/USD 1.

815-20-55-223 The combination of options used by Entity JPN as a hedging instrument is deemed to be a net purchased option based on the provisions of this Subtopic. Therefore, the hedging relationship avoids being subject to the hedge effectiveness test for written options in paragraph 815-20-25-94.

815-20-55-224 In particular, as it relates to paragraph 815-20-25-89(a), the aggregate premium (that is, the time values) for the three options comprising the hedging instrument results in Entity JPN paying a net premium.

815-20-55-225 The evaluation of whether a net premium has been received under paragraph 815-20-25-89(a) must include consideration of only the time value components of the options designated as the hedging instrument. That evaluation must not include the intrinsic value, if any, of the options.

>> Example 29: Overall Cash Flows on a Group of Variable-Rate, Interest-Bearing Loans as Hedged Item

815-20-55-226 Paragraph superseded by Accounting Standards Update No. 2017-12. This Example illustrates application of the implementation guidance beginning in paragraph 815-20-55-33A on applying a first-payments-received technique in hedging variable nonbenchmark interest payments on a group of loans.

815-20-55-227 Paragraph superseded by Accounting Standards Update No. 2017-12. Entity A, a U.S. entity, makes prime rate based loans to its customers for which interest payments are due at the beginning of each month, based on the preceding month's beginning prime rate being applied to the average outstanding balance throughout the preceding month. Entity A determines that it will always have at least \$100 million of those prime rate based loans outstanding throughout the next 3 years, even though the composition of those loans in the rolling portfolio will likely change to some degree due to prepayments, loan sales, defaults, and additional lending. Replacement of loans within the portfolio may involve loans existing at the inception of the hedging relationship or loans originated after the inception of the hedging relationship.

815-20-55-228 Paragraph superseded by Accounting Standards Update No. 2017-12. Entity A wishes to hedge the variability in cash flows (resulting from changes in the prime interest rate) from its monthly interest receipts on \$100 million principal of those prime rate based loans by entering into a 3-year interest rate swap that provides for monthly net settlements based on the entity receiving a fixed interest rate on a \$100 million notional amount and paying a variable rate based on a specific prime rate index on a \$100 million notional amount.

815-20-55-229 Paragraph superseded by Accounting Standards Update No. 2017-12. Based on the guidance beginning in paragraph 815-20-55-33A, Entity A may identify the hedged forecasted transactions in its cash flow hedge by designating the hedging relationships as hedging the risk of changes in the entity's first prime rate based interest payments received during each 4-week period that begins 1 week before each monthly due date for the next 3 years that, in the aggregate for each month, are interest payments on \$100 million principal of its then-existing prime rate indexed variable rate loans.

> > Example 30: Application of the Net Written Option Test to Collar-Based Hedging Relationships

815-20-55-230 This Example illustrates the application of paragraph 815-20-25-95.

815-20-55-231 Entity X has LIBOR-indexed floating-rate debt. To hedge its exposure to variability in expected future cash outflows attributable to changes in **LIBOR swap rate** (the contractually specified interest rate), it enters into an interest rate collar with a bank when the current LIBOR swap rate is 6 percent. The collar also is indexed to LIBOR and consists of a purchased cap with the strike rate equal to 8 percent and a written floor with the strike rate equal to 5 percent. The purchased cap goes into effect when LIBOR increases above 8 percent, and the written floor goes into effect when LIBOR decreases below 5 percent. Thus, the interest collar has the effect of limiting the interest rate of the floating-rate debt to a range between 5 percent and 8 percent. On the basis of market conditions as of the collar transaction date, Entity X received a net premium from the bank.

815-20-55-232 In accordance with paragraphs 815-20-25-88 through 25-90, the combination of options in the collar in this Example is a net written option from Entity X's perspective. Therefore, the written-option test in paragraphs 815-20-25-94 through 25-95 must be applied to determine whether the hedging relationship between the debt and the collar qualifies for cash flow hedge accounting. That test requires that the combination of the hedged item and the written option provides at least as much potential for favorable cash flows as exposure to unfavorable cash flows for all possible percentage changes (from zero percent to 100 percent) in the LIBOR index.

815-20-55-233 The following table shows the calculation of the favorable cash flows and unfavorable cash flows for LIBOR changes of 50 percent.

[For ease of readability, the new table is not underlined.]

Potential Cash Flows of the Combination of the Hedged Item and the Net Written Option If LIBOR Moves Each Direction by the Same Percentage

	LIBOR at Inception	LIBOR Increase 50%	LIBOR Decrease 50%
Cash outflows on LIBOR-indexed debt	6.00%	9.00%	3.00%
Cash outflows on written floor	0.00	0.00	2.00
Less: Cash inflows on purchased cap	0.00	1.00	0.00
Net cash flow (outflows + / inflows -)	6.00%	8.00%	5.00%
		Unfavorable	Favorable
Change in cash flows of combination from inception (in basis points)		200	-100
Percentage change in cash flows of combination from inception		33.33%	-16.67%

815-20-55-234 The calculations in the table in paragraph 815-20-55-233 demonstrate that for a 50 percent fluctuation in the LIBOR rate, the collar would fail the written-option test in paragraph 815-20-25-94 because a 50 percent favorable change in LIBOR (that is, a decrease) would not provide at least as much favorable cash flows as unfavorable cash flows that would result from a 50 percent unfavorable change in LIBOR (that is, an increase). Therefore, the combination of options would not be an eligible hedging instrument.

> > Example 31: Option Time Value Excluded from the Assessment of Effectiveness in a Cash Flow Hedge and Recorded in Earnings under an Amortization Approach

815-20-55-235 This Example illustrates the application of paragraph 815-20-25-83A.

815-20-55-236 On December 31, 20X0, an entity intends to purchase 1,000 barrels of crude oil in December 20X4. The entity decides to hedge changes in the price of the crude oil by purchasing an at-the-money call option on 1,000 barrels of crude oil. The entity purchases the option on December 31, 20X0, with an initial premium of \$9,250, a strike price of \$75, and a maturity date of December 31, 20X4. The entity designates the option as the hedging instrument in a cash flow hedge of a forecasted purchase of crude oil.

815-20-55-237 The entity elects to exclude the time value of the option from the assessment of effectiveness in accordance with paragraph 815-20-25-82 and applies the amortization approach for recognizing excluded components in accordance with paragraph 815-20-25-83A. The entity applies a straight-line amortization method and, based on the initial option premium of \$9,250, the entity determines an annual amortization amount of \$2,313. The entity records all changes in fair value over the term of the derivative in other comprehensive income and records amortization in earnings each period with an offsetting entry to other comprehensive income. The changes in value of the option over the life of the hedging relationship are as follows.

[For ease of readability, the new table is not underlined.]

	12/31/20X1	12/31/20X2	12/31/20X3	12/31/20X4
Ending market price of crude oil	\$ 77	\$ 76	\$ 74	\$ 81
Ending fair value of option:				
Time value	7,500	5,500	3,000	-
Intrinsic value	2,000	1,000	-	6,000
Total	<u>\$ 9,500</u>	<u>\$ 6,500</u>	<u>\$ 3,000</u>	<u>\$ 6,000</u>
Change in time value	\$ (1,750)	\$ (2,000)	\$ (2,500)	\$ (3,000)
Change in intrinsic value	2,000	(1,000)	(1,000)	6,000
Total current-period gain (loss) on derivative	<u>\$ 250</u>	<u>\$ (3,000)</u>	<u>\$ (3,500)</u>	<u>\$ 3,000</u>

815-20-55-238 On December 31, 20X4, the entity purchases 1,000 barrels of crude oil, and the option expires with an intrinsic value of \$6,000. This amount will remain in accumulated other comprehensive income until the commodity is sold in 20X5. The journal entries over the life of the hedging relationship are as follows.

December 31, 20X0			
Derivative asset		\$ 9,250	
Cash			\$ 9,250
To record the derivative asset based on the initial premium.			

December 31, 20X1

<u>Derivative asset</u>	<u>\$ 250</u>	
<u>Other comprehensive income</u>		<u>\$ 250</u>
<u>To record the change in value of the derivative in other comprehensive income.</u>		
 <u>Cost of goods sold</u>	 <u>\$ 2,313</u>	
<u>Other comprehensive income</u>		<u>\$ 2,313</u>
<u>To record amortization of the excluded amount.</u>		

December 31, 20X2

<u>Other comprehensive income</u>	<u>\$ 3,000</u>	
<u>Derivative asset</u>		<u>\$ 3,000</u>
<u>To record the change in value of the derivative in other comprehensive income.</u>		
 <u>Cost of goods sold</u>	 <u>\$ 2,313</u>	
<u>Other comprehensive income</u>		<u>\$ 2,313</u>
<u>To record amortization of the excluded amount.</u>		

December 31, 20X3

<u>Other comprehensive income</u>	<u>\$ 3,500</u>	
<u>Derivative asset</u>		<u>\$ 3,500</u>
<u>To record the change in value of the derivative in other comprehensive income.</u>		
 <u>Cost of goods sold</u>	 <u>\$ 2,313</u>	
<u>Other comprehensive income</u>		<u>\$ 2,313</u>
<u>To record amortization of the excluded amount.</u>		

December 31, 20X4

<u>Derivative asset</u>	<u>\$ 3,000</u>	
<u>Other comprehensive income</u>		<u>\$ 3,000</u>
<u>To record the change in value of the derivative in other comprehensive income.</u>		
 <u>Cost of goods sold</u>	 <u>\$ 2,311</u>	^a
<u>Other comprehensive income</u>		<u>\$ 2,311</u>
<u>To record amortization of the excluded amount.</u>		

July 1, 20X5

<u>Accumulated other comprehensive income</u>	<u>\$ 6,000</u>	
<u>Cost of goods sold</u>		<u>\$ 6,000</u>
<u>Upon sale of commodity, to record intrinsic value to cost of goods sold.</u>		

(a) \$2 rounding adjustment

13. Add paragraph 815-20-65-3 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2017-12, Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities

815-20-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*:

- a. For **public business entities**, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years.
- b. For all other entities, the pending content that links to this paragraph shall be effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.
- c. Early adoption, including adoption in an interim period, of the pending content that links to this paragraph is permitted. If an entity early adopts the pending content that links to this paragraph in an interim period, any adjustments shall be reflected as of the beginning of the fiscal year that includes that interim period (that is, the initial application date).
- d. For **cash flow hedges** and net investment hedges existing (that is, the hedging instrument has not expired, been sold, terminated, or exercised or the entity has not removed the designation of the hedging relationship) as of the date of adoption, an entity shall apply the pending content that links to this paragraph related to the elimination of the separate measurement of ineffectiveness by means of a cumulative-effect adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
- e. An entity may elect any of the following items upon adoption of the pending content that links to this paragraph:
 1. For a **fair value hedge of interest rate risk** existing as of the date of adoption, an entity may modify the measurement methodology for a hedged item in accordance with either paragraph 815-20-25-6B or paragraph 815-25-35-13 without dedesignation of the hedging relationship. The cumulative basis adjustment carried forward shall be adjusted to an amount that reflects what the cumulative basis adjustment would have been at the date of adoption had the modified measurement methodology been used in all past periods in which the hedging relationship was outstanding. When making this election, the benchmark rate component of the contractual coupon cash flows shall be determined as of the hedging relationship's

original inception date. The cumulative effect of applying this election shall be recognized as an adjustment to the basis adjustment of the hedged item recognized on the balance sheet with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.

2. For the fair value hedges of interest rate risk for which an entity modifies the measurement methodology for the hedged item based on the benchmark rate component of the contractual coupon cash flows in accordance with (1) above, an entity may elect to dedesignate a portion of the hedged item and reclassify the basis adjustment associated with the portion of the hedged item dedesignated to the opening balance of retained earnings as of the initial application date.
3. For fair value hedges existing as of the date of adoption in which foreign exchange risk is the hedged risk or one of the hedged risks and a currency swap is the hedging instrument, an entity may, without dedesignation, modify its hedge documentation to exclude the cross-currency basis spread component of the currency swap from the assessment of hedge effectiveness and recognize the excluded component through an amortization approach. The cumulative effect of applying this election shall be recognized as an adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
4. For hedges existing as of the date of adoption that exclude a portion of the hedging instrument from the assessment of effectiveness, an entity may modify the recognition model for the excluded component from a mark-to-market approach to an amortization approach without dedesignation of the hedging relationship. The cumulative effect of applying this election shall be recognized as an adjustment to accumulated other comprehensive income with a corresponding adjustment to the opening balance of retained earnings as of the initial application date.
5. An entity may modify documentation without dedesignating an existing hedging relationship to specify the following:
 - i. For hedging relationships that currently use a quantitative method to assess effectiveness, that subsequent prospective and retrospective effectiveness assessments shall be performed qualitatively in accordance with paragraph 815-20-25-3(b)(2)(iv)(03)
 - ii. For hedging relationships that currently use the shortcut method to assess effectiveness, the quantitative method that would be used to perform assessments of effectiveness in accordance with paragraph 815-20-25-117A if the entity determines at a later date that use of the shortcut method was not or no longer is appropriate.

6. For cash flow hedges existing as of the date of adoption in which the hedged risk is designated as the variability in total cash flows that meet the requirements to designate as the hedged risk the variability in cash flows attributable to changes in a **contractually specified component** or a contractually specified interest rate, an entity may:
 - i. Modify the hedging relationship, without dedesignation, to specify the hedged risk is the variability in the contractually specified component or contractually specified interest rate
 - ii. 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 Subtopic 815-30) in the assessment of effectiveness on the basis of market data as of the inception of the hedging relationship
 - iii. Consider any ineffectiveness previously recognized on the hedging relationship as part of the transition adjustment in accordance with (d) above.
7. An entity may reclassify a debt security from held-to-maturity to available-for-sale if the debt security is eligible to be hedged under the last-of-layer method in accordance with paragraph 815-20-25-12A. Any unrealized gain or loss at the date of the transfer shall be recorded in accumulated other comprehensive income in accordance with paragraph 320-10-35-10(c).
- f. For private companies that are not financial institutions as described in paragraph 942-320-50-1 and **not-for-profit entities** (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market), the elections in (e) above shall be determined before the next interim (if applicable) or annual **financial statements are available to be issued.**
- g. For all other entities, the elections in (e) above shall be determined before the first quarterly effectiveness assessment date after the date of adoption.
- h. For fair value hedges existing as of the date of adoption in which the hedged item is a tax-exempt **financial instrument**, the hedged risk may be modified to interest rate risk related to the **Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate**. The modification shall be considered a dedesignation and immediate redesignation of the hedging relationship. In this situation, the cumulative basis adjustment of the hedged item from the dedesignated hedging relationship shall be amortized to earnings on a level-yield basis over a period of time based on the applicable requirements in other Topics.
- i. An entity is not required to apply the guidance in paragraph 815-20-25-81 when comparing hedging relationships executed before and after the date of adoption of the pending content that links to this paragraph for any of the following:

1. Hedging relationships executed before the date of adoption assessed under the shortcut method for which hedge documentation was not amended as permitted by (e)(5)(ii) above, and hedging relationships executed after the date of adoption assessed under the shortcut method in accordance with paragraphs 815-20-25-117A through 25-117D
 2. Hedging relationships executed before the date of adoption for which the hedged risk was not amended to a contractually specified component or a contractually specified interest rate as permitted by (e)(6) above, and hedging relationships executed after the date of adoption for which the hedged risk is the variability in cash flows attributable to changes in a contractually specified component or a contractually specified interest rate
 3. Hedging relationships executed before the date of adoption for which the recognition of excluded components was not amended to an amortization approach as permitted by (e)(4) above, and hedging relationships executed after the date of adoption for which an amortization approach is elected in accordance with paragraph 815-20-25-83A.
- j. On a prospective basis only for existing hedging relationships on the date of adoption (in all interim periods and fiscal years ending after the date of adoption), an entity shall:
1. Present the entire change in the fair value of the hedging instrument in the same income statement line item as the earnings effect of the hedged item when the hedged item affects earnings (with the exception of amounts excluded from the assessment of hedge effectiveness in a net investment hedge) in accordance with paragraphs 815-20-45-1A and 815-20-45-1C
 2. Disclose the items in the pending content that links to this paragraph in Subtopic 815-10.
- k. An entity shall provide the following disclosures within Topic 250 on accounting changes and error corrections:
1. The nature of and reason for the change in accounting principle
 2. The cumulative effect of the change on the opening balance of each affected component of equity or net assets in the statement of financial position as of the date of adoption
 3. The disclosures in (1) through (2) above in each interim and annual financial statement period in the fiscal year of adoption.

Amendments to Subtopic 815-25

14. Amend paragraph 815-25-05-1, with a link to transition paragraph 815-20-65-3, as follows:

Derivatives and Hedging—Fair Value Hedges

Overview and Background

815-25-05-1 This Subtopic provides incremental guidance on accounting for and financial reporting of **fair value hedges** established under the criteria in Subtopic 815-20, such as subsequent measurement and dedesignation of a fair value hedging relationship. Implementation guidance and examples specific to fair value hedges are included in both Subtopic 815-20 and this Subtopic ~~815-20~~.

Scope and Scope Exceptions

> Overall Guidance

815-25-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in Subtopic 815-20, see Section 815-20-15.

Recognition

815-25-25-1 See Section 815-20-25 for the criteria under which an entity may designate a **derivative instrument** as hedging the exposure to changes in the **fair value** of an asset or a liability or an identified portion thereof (hedged item) that is attributable to a particular risk. Paragraph 815-10-05-5 states that references to an asset or a liability in this Topic include a firm commitment.

15. Amend paragraphs 815-25-35-1, 815-25-35-4, 815-25-35-7, 815-25-35-13 through 35-14 and the related heading, and 815-25-35-19, supersede paragraphs 815-25-35-2 through 35-3 and 815-25-35-5, and add paragraphs 815-25-35-7A and its related heading, 815-25-35-9A, 815-25-35-13A through 35-13B and their related headings, and the heading preceding paragraph 815-25-35-14, with a link to transition paragraph 815-20-65-3, as follows:

Subsequent Measurement

> Changes in Fair Value in General

815-25-35-1 Gains and losses on a qualifying **fair value hedge** shall be accounted for as follows:

- a. The gain or loss on the hedging instrument shall be recognized currently in earnings, except for amounts excluded from the assessment of effectiveness that are recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A. All amounts recognized in earnings shall be presented in the same income statement line item as the earnings effect of the hedged item.
- b. The gain or loss (that is, the change in **fair value**) on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized currently in earnings.

815-25-35-2 Paragraph superseded by Accounting Standards Update No. 2017-12. If the fair value hedge is fully effective, the gain or loss on the hedging instrument, adjusted for the component, if any, of that gain or loss that is excluded from the assessment of effectiveness under the entity's defined risk management strategy for that particular hedging relationship (as discussed in paragraphs 815-20-25-81 through 25-83), would exactly offset the loss or gain on the hedged item attributable to the hedged risk. Any difference that does arise would be the effect of hedge ineffectiveness, which consequently is recognized currently in earnings.

815-25-35-3 Paragraph superseded by Accounting Standards Update No. 2017-12. The measurement of hedge ineffectiveness for a particular hedging relationship shall be consistent with the entity's risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 815-20-25-3. Nevertheless, the amount of hedge ineffectiveness recognized in earnings is based on the extent to which exact offset is not achieved.

815-25-35-4 Although a hedging relationship must comply with an entity's established policy range of what is considered highly effective pursuant to paragraphs 815-20-25-75 through 25-85 for that relationship to qualify for hedge accounting, that compliance does not assure perfect offset between the gain or loss on the hedging instrument and the hedged item attributable to the hedged risk. Any gain or loss on the hedging instrument that does not offset the gain or loss on the hedged item attributable to the hedged risk is recognized in earnings in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A. zero ineffectiveness. Any hedge ineffectiveness directly affects earnings because there will be no offsetting

adjustment of a hedged item's carrying amount for the ineffective aspect of the gain or loss on the related hedging instrument.

815-25-35-5 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~In all instances, the actual measurement of hedge ineffectiveness to be recognized in earnings each reporting period is based on the extent to which exact offset is not achieved as specified in paragraph 815-25-35-2. That requirement applies even if a regression or other statistical analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness supports an expectation that the hedging relationship will be highly effective and demonstrates that it has been highly effective, respectively.~~

815-25-35-6 If a hedged item is otherwise measured at fair value with changes in fair value reported in **other comprehensive income** (such as an available-for-sale debt security), the adjustment of the hedged item's carrying amount discussed in paragraph 815-25-35-1(b) shall be recognized in earnings rather than in other comprehensive income to offset the gain or loss on the hedging instrument.

815-25-35-7 If an entity has designated and documented that it will ~~measure~~ assess effectiveness and measure hedge results on an after-tax basis as permitted by paragraph 815-20-25-3(b)(2)(vi), the portion of the gain or loss on the hedging instrument that exceeded the loss or gain on the hedged item shall be included as an offset to the related tax effects in the period in which those tax effects are recognized.

> Estimating the Remaining Balance under the Last-of-Layer Method

815-25-35-7A When the hedged item is designated and accounted for under the last-of-layer method in accordance with paragraph 815-20-25-12A, an entity shall perform and document at each effectiveness assessment date an analysis that supports the entity's expectation that the hedged item (that is, the designated last of layer) is still anticipated to be outstanding as of the hedged item's assumed maturity date. That analysis shall incorporate the entity's current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows using a method consistent with the method used to perform the analysis in paragraph 815-20-25-12A(a).

> Changes in Fair Value of Hedged Item

815-25-35-8 The adjustment of the carrying amount of a hedged asset or liability required by paragraph 815-25-35-1(b) shall be accounted for in the same manner as other components of the carrying amount of that asset or liability. For example, an adjustment of the carrying amount of a hedged asset held for sale (such as inventory) would remain part of the carrying amount of that asset until the asset is

sold, at which point the entire carrying amount of the hedged asset would be recognized as the cost of the item sold in determining earnings.

815-25-35-9 An adjustment of the carrying amount of a hedged interest-bearing **financial instrument** shall be amortized to earnings. Amortization shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

815-25-35-9A For an outstanding hedging relationship, any amortization of adjustments to the carrying amount of the hedged item shall be performed assuming that the amortization period is the remaining life of the hedging relationship. For a discontinued hedging relationship, all remaining adjustments to the carrying amount of the hedged item shall be amortized over a period that is consistent with the amortization of other discounts or premiums associated with the hedged item in accordance with other Topics (for example, Subtopic 310-20 on receivables—nonrefundable fees and other costs).

> > Impairment of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment for that type of asset or for recognizing an increased obligation for that type of liability. Those impairment requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment requirements to the hedged asset or liability.

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

Editor's Note: *The content of paragraph 815-25-35-10 will be amended upon transition, together with a change in the heading noted below.*

> > Impairment or Credit Losses of Hedged Item

815-25-35-10 An asset or liability that has been designated as being hedged and accounted for pursuant to this Section remains subject to the applicable requirements in generally accepted accounting principles (GAAP) for assessing impairment or credit losses for that type of asset or for recognizing an increased

obligation for that type of liability. Those impairment or credit loss requirements shall be applied after hedge accounting has been applied for the period and the carrying amount of the hedged asset or liability has been adjusted pursuant to paragraph 815-25-35-1(b). Because the hedging instrument is recognized separately as an asset or liability, its fair value or expected cash flows shall not be considered in applying those impairment or credit loss requirements to the hedged asset or liability.

> > > Interaction with Loan Impairment

815-25-35-11 This Subtopic implicitly affects the measurement of impairment under Section 310-10-35 by requiring the present value of expected future cash flows to be discounted by the new effective rate based on the adjusted **recorded investment** in a hedged loan. Paragraph 310-10-35-31 requires that, when the recorded investment of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted recorded investment. That paragraph states that the adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's recorded investment. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's carrying amount be adjusted for hedge accounting before the impairment requirements of Subtopic 310-10 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted recorded investment.

In addition, amend the following pending content for paragraph 815-25-35-11, with a link to transition paragraph 326-10-65-1:

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

Editor's Note: *The content of paragraph 815-25-35-11 will be amended upon transition, together with a change in the heading noted below.*

> > > Interaction with Measurement of Credit Losses

815-25-35-11 This Subtopic implicitly affects the measurement of credit losses under Subtopic 326-20 on financial instruments measured at amortized cost by requiring the present value of expected future cash flows to be discounted by the

new effective rate based on the adjusted amortized cost basis in a hedged loan. Paragraph 326-20-55-9 requires that, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. That paragraph states that the adjustment under fair value hedge accounting ~~of the loan's carrying amount~~ for changes in fair value attributable to the hedged risk under this Subtopic shall be considered to be an adjustment of the loan's amortized cost basis. As discussed in that paragraph, the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Because paragraph 815-25-35-10 requires that the loan's amortized cost basis ~~carrying amount~~ be adjusted for hedge accounting before the requirements of Subtopic 326-20 are applied, this Subtopic implicitly supports using the new effective rate and the adjusted amortized cost basis.

815-25-35-12 This guidance applies to all entities applying Subtopic 310-10 to financial assets that are hedged items in a fair value hedge, regardless whether those entities have delayed amortizing to earnings the adjustments of the loan's carrying amount arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's carrying amount.

In addition, amend the following pending content for paragraph 815-25-35-12, with a link to transition paragraph 326-10-65-1:

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

815-25-35-12 This guidance applies to all entities applying Subtopic 326-20 to financial assets that are hedged items in a fair value hedge, regardless of whether those entities have delayed amortizing to earnings the adjustments of the loan's amortized cost basis ~~carrying amount~~ arising from fair value hedge accounting until the hedging relationship is dedesignated. The guidance on recalculating the effective rate is not intended to be applied to all other circumstances that result in an adjustment of a loan's amortized cost basis ~~carrying amount~~.

> > Changes Involving Interest Rate Risk

815-25-35-13 In calculating the change in the hedged item's fair value attributable to changes in the **benchmark interest rate** (see paragraph 815-20-25-12(f)(2)), the estimated coupon cash flows used in calculating fair value shall be based on

either the full contractual coupon cash flows or the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception, all of the contractual cash flows of the entire hedged item. Excluding some of the hedged item's contractual cash flows (for example, the portion of the interest coupon in excess of the benchmark interest rate) from the calculation is not permitted—paragraph 815-20-25-12(a), which specifically permits the hedged item to be identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment is not affected by this provision.

> > > Measuring the Fair Value of a Prepayable Instrument in Hedges of Interest Rate Risk

815-25-35-13A In a hedge of interest rate risk in which the hedged item is a prepayable instrument in accordance with paragraph 815-20-25-6, 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 in accordance with paragraph 815-20-25-6B. For example, if an entity considers only how changes in the benchmark interest rate affect an obligor's decision to prepay a debt instrument when assessing hedge effectiveness, it shall consider only that factor when adjusting the carrying amount of the hedged item. The election to consider only how changes in the benchmark interest rate affect an obligor's decision to prepay a debt instrument does not affect an entity's election to use either the full contractual coupon cash flows or the benchmark rate component of the contractual coupon cash flows determined at hedge inception for purposes of measuring the change in fair value of the hedged item in accordance with paragraph 815-25-35-13.

> > > Partial-Term Hedges of Interest Rate Risk

815-25-35-13B For a fair value hedge of interest rate risk in which the hedged item is designated as selected contractual cash flows in accordance with paragraph 815-20-25-12(b)(2)(ii), an entity may measure the change in the fair value of the hedged item attributable to interest rate risk using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. The assumed maturity of the hedged item occurs on the date in which the last hedged cash flow is due and payable.

> > Interaction with Capitalization Rate for Assets under Construction

815-25-35-14 Amounts recorded in an entity's income statement as interest costs shall be reflected in the capitalization rate under Subtopic 835-20. Those amounts could include amortization of the adjustments of the carrying amount of the hedged liability, under paragraph paragraphs 815-25-35-9 through 35-9A, if an entity elects to begin amortization of those adjustments during the period in which interest is

eligible for capitalization. ~~The ineffective portion of the fair value hedge shall not be reflected in the capitalization rate.~~

> > Changes Involving Foreign Exchange Risk

815-25-35-15 Gains and losses on a qualifying foreign currency fair value hedge shall be accounted for as specified in Section 815-25-40 and paragraphs 815-25-35-1 through 35-10.

815-25-35-16 If a nonderivative instrument qualifies as a hedging instrument under paragraph 815-20-25-58, the gain or loss on the nonderivative hedging instrument attributable to foreign currency risk shall be the foreign currency transaction gain or loss as determined under Subtopic 830-20. The foreign currency transaction gain or loss on a hedging instrument shall be determined, consistent with paragraph 830-20-35-1, as the increase or decrease in functional currency cash flows attributable to the change in spot exchange rates between the functional currency and the currency in which the hedging instrument is denominated. That foreign currency transaction gain or loss shall be recognized currently in earnings along with the change in the carrying amount of the hedged firm commitment.

815-25-35-17 Paragraph not used.

815-25-35-18 Remeasurement of hedged foreign-currency-denominated assets and liabilities is based on the guidance in Subtopic 830-20, which requires remeasurement based on spot exchange rates, regardless of whether a fair value hedging relationship exists.

> Entities That Do Not Report Earnings

815-25-35-19 An entity that does not report earnings as a separate caption in a statement of financial performance (for example, a not-for-profit entity [NFP] or a defined benefit pension plan) shall recognize the gain or loss on a hedging instrument as a change in net assets in the period of change unless the hedging instrument is designated as a hedge of the foreign currency exposure of a net investment in a foreign operation. In that circumstance, the provisions of paragraphs 815-20-25-66 and 815-35-35-1 through 35-2 shall be applied. Entities that do not report earnings shall recognize the changes in the carrying amount of the hedged item pursuant to paragraphs 815-25-35-1 and 815-25-35-4 through 35-4 in a fair value hedge as a change in net assets in the period of change.

16. Amend paragraph 815-25-40-2 and add paragraphs 815-25-40-7 through 40-9 and their related headings, with a link to transition paragraph 815-20-65-3, as follows:

Derecognition

> Discontinuing Hedge Accounting

815-25-40-1 An entity shall discontinue prospectively the accounting specified in paragraphs 815-25-35-1 through 35-6 for an existing hedge if any one of the following occurs:

- a. Any criterion in Section 815-20-25 is no longer met.
- b. The **derivative instrument** expires or is sold, terminated, or exercised.
- c. The entity removes the designation of the **fair value hedge**.

815-25-40-1A For the purposes of applying the guidance in paragraph 815-25-40-1, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument.

815-25-40-2 In ~~these~~ the circumstances discussed in paragraph 815-25-40-1, the entity may elect to designate prospectively a new hedging relationship with a different hedging instrument or, in the circumstances described in (a) and (c) in paragraph 815-25-40-1, a different hedged item or a hedged **transaction** if the hedging relationship meets the criteria specified in Section 815-20-25 for a fair value hedge or a **cash flow hedge**.

> > Noncompliance with Effectiveness Criterion

815-25-40-3 In general, if a periodic assessment indicates noncompliance with the effectiveness criterion in paragraphs 815-20-25-75 through 25-80, an entity shall not recognize the adjustment of the carrying amount of the hedged item described in paragraphs 815-25-35-1 through 35-6 after the last date on which compliance with the effectiveness criterion was established.

815-25-40-4 However, if the event or change in circumstances that caused the hedging relationship to fail the effectiveness criterion can be identified, the entity shall recognize in earnings the changes in the hedged item's **fair value** attributable to the risk being hedged that occurred before that event or change in circumstances.

> > Hedged Item No Longer Meets Definition of Firm Commitment

815-25-40-5 If a fair value hedge of a **firm commitment** is discontinued because the hedged item no longer meets the definition of a firm commitment, the entity shall do both of the following:

- a. Derecognize any asset or liability previously recognized pursuant to paragraph 815-25-35-1(b) (because of an adjustment to the carrying amount for the firm commitment)
- b. Recognize a corresponding loss or gain currently in earnings.

815-25-40-6 A pattern of discontinuing hedge accounting and derecognizing firm commitments would call into question the firmness of future hedged firm commitments and the entity's accounting for future hedges of firm commitments.

> > Amounts Excluded from the Assessment of Effectiveness under an Amortization Approach

815-25-40-7 When applying the guidance in paragraph 815-20-25-83A, any amounts remaining in accumulated other comprehensive income associated with amounts excluded from the assessment of effectiveness shall be recorded in earnings in the current period if the hedged item is derecognized. For all other discontinued fair value hedges, any amounts associated with the excluded component remaining in accumulated other comprehensive income shall be recorded in earnings in the same manner as other components of the carrying amount of the hedged asset or liability in accordance with paragraphs 815-25-35-8 through 35-9A.

> > Hedged Item Is Designated under the Last-of-Layer Method

815-25-40-8 For a hedging relationship designated under the last-of-layer method in accordance with paragraph 815-20-25-12A, an entity shall discontinue (or partially discontinue) hedge accounting in either of the following circumstances:

- a. If the entity cannot support on a subsequent testing date that the hedged item (that is, the designated last of layer) is anticipated to be outstanding in accordance with paragraph 815-25-35-7A, it shall at a minimum discontinue hedge accounting for the portion of the hedged item no longer expected to be outstanding at the hedged item's assumed maturity date.
- b. If on a subsequent testing date the outstanding amount of the closed portfolio of prepayable financial assets or one or more beneficial interests is less than the hedged item, the entity shall discontinue hedge accounting.

815-25-40-9 If a last-of-layer method hedging relationship is discontinued (or partially discontinued), the outstanding basis adjustment (or portion thereof) as of the discontinuation date shall be allocated to the individual assets in the closed portfolio using a systematic and rational method. An entity shall amortize those amounts over a period that is consistent with the amortization of other discounts or premiums associated with the respective assets in accordance with other Topics

(for example, Subtopic 310-20 on receivables–nonrefundable fees and other costs).

17. Amend paragraph 815-25-50-1, with a link to transition paragraph 815-20-65-3, as follows:

Disclosure

815-25-50-1 See Section 815-10-50 for overall guidance on disclosures. ~~An entity's disclosures for every annual and interim reporting period for which a statement of financial position and a statement of financial performance is presented shall include both of the following for **derivative instruments**, as well as nonderivative instruments that may give rise to foreign currency transaction gains or losses under Subtopic 830-20, that have been designated and have qualified as fair value hedging instruments and for the related hedged items:~~

- a. Subparagraph superseded by Accounting Standards Update No. 2017-12. ~~The net gain or loss recognized in earnings during the reporting period representing both of the following:~~
 1. ~~The amount of the hedges' ineffectiveness~~
 2. ~~The component of the derivative instruments' gain or loss, if any, excluded from the assessment of hedge effectiveness.~~
 3. ~~Subparagraph not used~~
- b. Subparagraph superseded by Accounting Standards Update No. 2017-12. ~~The amount of net gain or loss recognized in earnings when a hedged **firm commitment** no longer qualifies as a **fair value hedge**. [Content amended and moved to paragraph 815-10-50-4C(g)]~~

815-25-50-2 For guidance on qualitative disclosures, see paragraph 815-10-50-5.

18. Amend paragraphs 815-25-55-1, 815-25-55-4, 815-25-55-6 through 55-8, 815-25-55-10 through 55-13, 815-25-55-17, 815-25-55-23, 815-25-55-26 through 55-27, 815-25-55-29 through 55-31, 815-25-55-34 through 55-36 and the related heading, 815-25-55-38 through 55-39 and the related heading, 815-25-55-42 through 55-43, 815-25-55-46, 815-25-55-49, 815-25-55-51 through 55-52, 815-25-55-55 through 55-58, 815-25-55-61 through 55-68, 815-25-55-71 through 55-72, 815-25-55-74 through 55-77, 815-25-55-85 through 55-87, and 815-25-55-89, supersede paragraphs 815-25-55-78 through 55-83 and their related heading, and add paragraphs 815-25-55-56A through 55-56B and the heading preceding 815-25-55-57, 815-25-55-61A through 55-61C and their related heading, 815-25-55-88A and its related heading, and 815-25-55-91 through 55-108 and their related headings, with a link to transition paragraph 815-20-65-3, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Fair Value Hedge of Natural Gas Inventory with Futures Contracts

815-25-55-1 This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness ~~and measure hedge ineffectiveness~~ in a **fair value hedge** of natural gas inventory with futures contracts. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.

815-25-55-2 Entity A has 20,000 million British thermal units of natural gas stored at its location in West Texas. To hedge the **fair value** exposure of the natural gas, Entity A sells the equivalent of 20,000 million British thermal units of natural gas futures contracts on a national mercantile exchange. The futures contracts prices are based on delivery of natural gas at the Henry Hub gas collection point in Louisiana.

815-25-55-3 The price of Entity A's natural gas inventory in West Texas and the price of the natural gas that is the **underlying** for the futures contracts it sold will differ as a result of regional factors (such as location, pipeline transmission costs, and supply and demand). Entity A therefore may not automatically assume that the hedge will be highly effective at achieving offsetting changes in fair value, and it cannot assess effectiveness by looking solely to the change in the price of natural gas delivered to the Henry Hub. The use of a hedging instrument with a different underlying basis than the item or **transaction** being hedged is generally referred to as a cross-hedge. The principles for cross-hedges illustrated in this Example also apply to hedges involving other risks. For example, the effectiveness of a hedge of **interest rate risk** in which one interest rate is used as a surrogate for another interest rate would be evaluated in the same way as the natural gas cross-hedge in this Example.

815-25-55-4 Both at inception of the hedge and on an ongoing basis, Entity A might assess the hedge's expected effectiveness on a quantitative basis based on the extent of correlation in recent years for periods similar to the spot prices term of the futures contracts between the spot prices of natural gas in West Texas and at the Henry Hub. If those prices have been and are expected to continue to be highly correlated, Entity A might reasonably expect the changes in the fair value of the futures contracts attributable to changes in the spot price of natural gas at the Henry Hub to be highly effective in offsetting the changes in the fair value of its natural gas inventory. In assessing effectiveness during the term of the hedge, Entity A must take into account actual changes in spot prices in West Texas and

at the Henry Hub. The period of time over which correlation of prices should be assessed would be based on management's judgment in the particular circumstance.

815-25-55-5 Entity A may not assume that the change in the spot price of natural gas located at Henry Hub, Louisiana, is the same as the change in fair value of its West Texas inventory. The physical hedged item is natural gas in West Texas, not natural gas at the Henry Hub. In identifying the price risk that is being hedged, Entity A also may not assume that its natural gas in West Texas has a Louisiana natural gas component. Use of a price for natural gas located somewhere other than West Texas to assess the effectiveness of a fair value hedge of natural gas in West Texas would be inconsistent with this Subtopic and could result in an assumption that a hedge was highly effective when it was not. If the price of natural gas in West Texas is not readily available, Entity A might use a price for natural gas located elsewhere as a base for estimating the price of natural gas in West Texas. However, that base price must be adjusted to reflect the effects of factors, such as location, transmission costs, and supply and demand, that would cause the price of natural gas in West Texas to differ from the base price.

815-25-55-6 Consistent with Entity A's method of assessing whether the hedge is expected to be highly effective, the hedge would not be perfectly effective and there would be a net earnings effect ~~be ineffective~~ to the extent that the actual change in the fair value of the futures contracts attributable to changes in the spot price of natural gas at the Henry Hub did not offset the actual change in the spot price of natural gas in West Texas per million British thermal units multiplied by 20,000.

815-25-55-7 That method excludes the change in the fair value of the futures contracts attributable to changes in the difference between the spot price and the forward price of natural gas at the Henry Hub in ~~determining ineffectiveness~~ assessing effectiveness. The excluded amount would be ~~reported directly~~ recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A or a mark-to-market approach in accordance with paragraph 815-20-25-83B and presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A.

> > Example 2: Fair Value Hedge of Tire Inventory with a Forward Contract

815-25-55-8 This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness ~~and measure hedge ineffectiveness~~ in a fair value hedge of tire inventory with a forward contract. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.

815-25-55-9 Entity B manufactures tires. The production of those tires incorporates a variety of physical components, of which rubber and steel are the most significant, as well as labor and overhead. Entity B hedges its exposure to changes in the fair value of its inventory of 8,000 steel-belted radial tires by entering into a forward contract to sell rubber at a fixed price.

815-25-55-10 Entity B decides to perform subsequent hedge effectiveness assessments on a quantitative basis and bases ~~base~~ its assessment of ~~hedge effectiveness~~ on changes in the fair value of the forward contract attributable to changes in the spot price of rubber. To determine whether the forward contract is expected to be highly effective at offsetting the change in fair value of the tire inventory, Entity B could estimate and compare such changes in the fair value of the forward contract and changes in the fair value of the tires (computed as the market price per tire multiplied by 8,000 tires) for different rubber and tire prices. Entity B also should consider the extent to which past changes in the spot prices of rubber and tires have been correlated. Because tires are a nonfinancial asset and rubber is only an ingredient in manufacturing them, Entity B may not assess hedge effectiveness by looking to the change in the fair value of only the rubber component of the steel-belted radial tires (see paragraph 815-20-25-12(e)). Both at inception of the hedge and during its term, Entity B must base its assessment of hedge effectiveness on changes in the market price of steel-belted radial tires and changes in the fair value of the forward contract attributable to changes in the spot price of rubber.

815-25-55-11 It is unlikely that this transaction would be highly effective in achieving offsetting changes in fair value. However, if Entity B concludes that the hedge will be highly effective and the hedge otherwise qualifies for hedge accounting, ~~the ineffective part of the hedge would be measured consistent with Entity B's method of assessing whether the hedge is expected to be highly effective. Based on that method, the hedge would have a net earnings effect be ineffective~~ to the extent that the actual changes in the following amounts did not offset:

- a. The fair value of the forward contract attributable to the change in the spot price of rubber
- b. The market price of steel-belted radials multiplied by the number of tires in inventory.

815-25-55-12 Because Entity B bases its assessment of effectiveness on changes in spot prices, the change in the fair value of the forward contract attributable to changes in the difference between the spot and forward price of rubber would be excluded from the ~~measure of effectiveness and reported directly~~ assessment of effectiveness, recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A or a mark-to-market approach in accordance with paragraph 815-20-25-83B, and presented in the same income

statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A.

> > Example 3: Fair Value Hedge of Growing Wheat with Futures Contracts

815-25-55-13 This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness ~~and measure hedge ineffectiveness~~ in a fair value hedge of growing wheat with futures contracts. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.

815-25-55-14 Entity C has a tract of land on which it is growing wheat. Historically, Entity C has harvested at least 40,000 bushels of wheat from that tract of land. Two months before its expected harvest, Entity C sells 2-month futures contracts for 40,000 bushels of wheat, which it wants to designate as a fair value hedge of its growing wheat, rather than as a **cash flow hedge** of the projected sale of the wheat after harvest.

815-25-55-15 Even though the futures contracts are for the same type of wheat that Entity C expects to harvest in two months, the futures contracts and hedged wheat have different bases because the futures contracts are based on fully grown, harvested wheat, while the hedged item is unharvested wheat with two months left in its growing cycle. Entity C therefore may not automatically assume that the hedge will be highly effective in achieving offsetting changes in fair value.

815-25-55-16 To determine whether the futures contracts are expected to be highly effective in providing offsetting changes in fair value for the growing wheat, Entity C would need to estimate and compare the fair value of its growing wheat and of the futures contracts for different levels of wheat prices. Entity C may not base its estimate of the value of its growing wheat solely on the current price of wheat because that price is for grown, harvested wheat. Entity C might, however, use the current price of harvested wheat together with other relevant factors, such as additional production and harvesting costs and the physical condition of the growing wheat, to estimate the current fair value of its growing wheat crop.

815-25-55-17 It is unlikely that wheat futures contracts would be highly effective in offsetting the changes in value of growing wheat. ~~However, if Entity C concludes that the hedge qualifies as highly effective, it would use the same method for measuring actual hedge effectiveness that it uses initially and on an ongoing basis to assess whether the hedge is expected to be highly effective. The hedge would be ineffective to the extent that the actual changes in fair value of the futures contract and of the growing wheat crop did not offset.~~

815-25-55-18 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-25-55-19 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-25-55-20 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-25-55-21 Paragraph superseded by Accounting Standards Update No. 2016-01.

815-25-55-22 Paragraph superseded by Accounting Standards Update No. 2016-01.

> > Example 5: Fair Value Hedge of U.S. Treasury Bond with Put Options

815-25-55-23 This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness ~~and measure hedge ineffectiveness~~ in a fair value hedge of a U.S. Treasury bond with put options. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.

815-25-55-24 Entity E owns a U.S. Treasury bond and wants to protect itself against the fair value exposure to declines in the price of the bond. Entity E purchases an at-the-money put option on a U.S. Treasury security with the same terms (remaining maturity, **notional amount**, and interest rate) as the U.S. Treasury bond held and designates the option as a hedge of the fair value exposure of the U.S. Treasury bond. Entity E plans to hold the put option until it expires.

815-25-55-25 Because Entity E plans to hold the put option (a static hedge) rather than manage the position with a delta-neutral strategy, it could assess whether it expects the hedge to be highly effective at achieving offsetting changes in fair value by calculating and comparing the changes in the intrinsic value of the option and changes in the price (fair value) of the U.S. Treasury bond for different possible market prices. In assessing the expectation of effectiveness on an ongoing basis, Entity E also must consider the actual changes in the fair value of the U.S. Treasury bond and in the intrinsic value of the option during the hedge period.

815-25-55-26 However, because the pertinent critical terms of the option and the bond are the same in this Example, Entity E could expect the changes in value of the bond attributable to changes in interest rates and changes in the intrinsic value of the option to offset completely during the period that the option is in the money. That is, ~~there will be no ineffectiveness~~ the hedging relationship will be perfectly effective because Entity E has chosen to exclude changes in the option's time value from the assessment of hedge effectiveness. ~~effectiveness test. Because of that choice, Entity E must recognize~~ may elect to account for changes in the time

value of the option through an amortization approach in accordance with paragraph 815-20-25-83A or through a mark-to-market approach in accordance with paragraph 815-20-25-83B. Under either of those approaches, it should present the portion of excluded components recognized in earnings in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A directly in earnings.

> > Example 6: Fair Value Hedge of an Embedded Purchased Option with a Written Option

815-25-55-27 This Example illustrates the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 for how an entity may assess hedge effectiveness ~~and measure hedge ineffectiveness~~ in a fair value hedge of an embedded purchased option with a written option. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.

815-25-55-28 Entity F issues five-year, fixed-rate debt with an embedded (purchased) call option and, with a different counterparty, writes a call option to neutralize the call feature in the debt. The embedded call option and the written call option have the same **effective notional amount**, underlying fixed interest rate, and strike price. (The strike price of the option in the debt usually is referred to as the call price.) The embedded option also can be exercised at the same times as the written option. Entity F designates the written option as a fair value hedge of the embedded prepayment option component of the fixed-rate debt.

815-25-55-29 To assess whether the hedge is expected to be highly effective in achieving offsetting changes in fair value, Entity F could estimate and compare the changes in fair values of the two options for different market interest rates. Because this Subtopic does not permit **derivative instruments**, including embedded derivatives whether or not they are required to be accounted for separately, to be separated into components, Entity F can only designate a hedge of the entire change in fair value of the embedded purchased call option. The resulting changes in fair value will be included currently in earnings. Changes in the fair value of the written option also will be included currently in ~~earnings; any ineffectiveness thus~~ earnings and presented in the same income statement line item as the earnings effect of the hedged item. Any mismatch between the changes in fair values of the hedging instrument and the hedged item attributable to the hedged risk, thus, will be automatically reflected in earnings. (The hedge is likely to have some ~~ineffectiveness earnings effect~~ because the premium for the written call option is unlikely to be the same as the premium for the embedded purchased call option.)

> > Example 7: Fair Value Hedge of a Commodity Inventory

815-25-55-30 The following Cases illustrate application of the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 to a fair value hedge of a commodity inventory:

- a. The terms of the hedging derivative have been negotiated such that the hedging relationship is perfectly effective to produce no ineffectiveness in the hedging relationship (Case A).
- b. ~~There is ineffectiveness in the~~ The hedging relationship is not perfectly effective (Case B).

815-25-55-31 To simplify the illustration and focus on basic concepts, the derivative instrument in Cases A and B is assumed to have no time value. In practice, a derivative instrument used for a fair value hedge of a commodity would have a time value that would change over the term of the hedging relationship. The changes in that time value ~~would be recognized in earnings~~ may be accounted for through an amortization approach in accordance with paragraph 815-20-25-83A or a mark-to-market approach in accordance with paragraph 815-20-25-83B. Under either of those approaches, the portion of excluded components recognized in earnings should be presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A as they occur, either because they represent ineffectiveness or because they are excluded from the assessment of effectiveness (as discussed in paragraphs 815-20-25-81 through 25-83).

815-25-55-32 Other Examples in this Section illustrate accounting for the time value component of a derivative instrument.

815-25-55-33 For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-25-55-34 Cases A and B share all of the following assumptions:

- a. Entity ABC decides to hedge the risk of changes during the period in the overall fair value of its entire inventory of Commodity A by entering into a derivative instrument, Derivative Z.
- b. On the first day of Period 1, Entity ABC enters into Derivative Z and neither receives nor pays a premium (that is, the fair value at inception is zero).
- c. Entity ABC designates the derivative instrument as a hedge of the changes in fair value of the inventory due to changes in the price of Commodity A during Period 1.

- d. The hedging relationship qualifies for fair value hedge accounting. Entity ABC will assess effectiveness on a quantitative basis both initially and subsequently by comparing the entire change in fair value of Derivative Z with the change in the market price of the hedged commodity inventory.

> > > Case A: ~~No Ineffectiveness~~ Perfect Effectiveness in the Hedging Relationship

815-25-55-35 In this Case, Entity ABC expects the hedge to be perfectly effective ~~no ineffectiveness~~ because both of the following conditions exist:

- The notional amount of Derivative Z matches the amount of the hedged inventory (that is, Derivative Z is based on the same number of bushels as the number of bushels of the commodity that Entity ABC designated as hedged).
- The underlying of Derivative Z is the price of the same variety and grade of Commodity A as the inventory at the same location.

815-25-55-36 At inception of the hedge, Derivative Z has a fair value of zero and the hedged inventory has a carrying amount of \$1,000,000 and a fair value of \$1,100,000. On the last day of Period 1, the fair value of Derivative Z has increased by \$25,000, and the fair value of the inventory has decreased by \$25,000. The inventory is sold, and Derivative Z is settled on the last day of Period 1. The following table illustrates the accounting for the situation described in this Case.

	Debit (Credit)		
	Cash	Derivative	Inventory
Period 1			
Recognize change in fair value of derivative		\$ 25,000	
Recognize change in fair value of inventory			\$ (25,000)
Recognize revenue from sale	\$ 1,075,000		
Recognize cost of sale of inventory			(975,000)
Recognize settlement of derivative	25,000	(25,000)	
Total	\$ 1,100,000	\$ -	\$ (100,000)

(a) For presentation purposes, the change in the fair value of the hedging instrument is in the same income statement line item as the hedged item.

815-25-55-37 If Entity ABC had sold the hedged inventory at the inception of the hedge, its gross profit on that sale would have been \$100,000. This Case illustrates that, by hedging the risk of changes in the overall fair value of its inventory, Entity ABC recognized the same gross profit at the end of the hedge period even though the fair value of its inventory decreased by \$25,000.

> > > **Case B: Ineffectiveness in the Hedging Relationship Is Not Perfectly Effective**

815-25-55-38 ~~No ineffectiveness was recognized in earnings~~ The hedge in Case A was perfectly effective because the gain on Derivative Z exactly offsets the loss on the inventory. However, in this Case, assume the terms of Derivative Z do not perfectly match the inventory and its fair value has increased by \$22,500 as compared with the decline in fair value of the inventory of \$25,000. ~~Ineffectiveness~~ The mismatch of \$2,500 has to be recognized in earnings and presented in the same income statement line item as the earnings effect of the hedged item. The following table illustrates the accounting for the situation described in this Case.

	Debit (Credit)			
	Cash	Derivative	Inventory	Earnings ^(a)
Period 1				
Recognize change in fair value of derivative		\$ 22,500		\$ (22,500)
Recognize change in fair value of inventory			\$ (25,000)	25,000
Recognize revenue from sale	\$ 1,075,000			(1,075,000)
Recognize cost of sale of inventory			(975,000)	975,000
Recognize settlement of derivative	22,500	(22,500)		
Total	\$ 1,097,500	\$ -	\$ (1,000,000)	\$ (97,500)

(a) For presentation purposes, the change in the fair value of the hedging instrument is in the same income statement line item as the hedged item.

815-25-55-39 The difference between the effect on earnings in Case B and the effect on earnings in Case A is \$2,500 ~~the \$2,500 of hedge ineffectiveness.~~

> > **Example 8: Fair Value Hedge of Fixed-Rate Interest-Bearing Debt**

815-25-55-40 This Example demonstrates the guidance in Subtopic 815-20 and this Subtopic as applied to the mechanics of reporting an interest rate swap used as a fair value hedge of an interest-bearing liability. It is not intended to demonstrate how to compute the fair value of an interest rate swap or an interest-bearing liability. This Example has been simplified by assuming that the interest rate applicable to a payment due at any future date is the same as the rate for a payment due at any other date (that is, the yield curve is flat). Although that is an unrealistic assumption, it makes the amounts used easier to understand without detracting from the purpose of the Example. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-25-55-41 The fair values of the interest rate swap in this Example are determined using the **zero-coupon method**. The zero-coupon method is not the only acceptable method. Explanations of other acceptable methods of determining the fair value of an interest rate swap can be obtained from various published

sources. Fair values also may be available from dealers in interest rate swaps and other derivative instruments.

815-25-55-42 In this Example, the term and notional amount of the interest rate swap match the term and principal amount of the interest-bearing liability being hedged. The fixed and variable interest rates used to determine the net settlements on the interest rate swap match the current yield curve, and the sum of the present values of the expected net settlements is zero at inception. Thus, paragraphs 815-20-25-102 through 25-106 permit the reporting entity to assume perfect effectiveness ~~that there will be no ineffectiveness~~. Assessment of effectiveness at one of the interest rate swap's repricing dates would confirm the validity of that assumption.

815-25-55-43 A shortcut method (see paragraphs 815-20-25-102 through 25-106) can be used to produce the same reporting results as the method illustrated in this Example. This shortcut is only appropriate for a fair value hedge of a fixed-rate asset or liability using an interest rate swap and only if the assumption of perfect effectiveness ~~no ineffectiveness~~ is appropriate. The steps in the shortcut method are as follows:

- a. Determine the difference between the fixed rate to be received on the interest rate swap and the fixed rate to be paid on the bonds.
- b. Combine that difference with the variable rate to be paid on the interest rate swap.
- c. Compute and recognize interest expense using that combined rate and the fixed-rate liability's principal amount. (Amortization of any purchase premium or discount on the liability also must be considered, although that complication is not incorporated in this Example.)
- d. Determine the fair value of the interest rate swap.
- e. Adjust the carrying amount of the interest rate swap to its fair value and adjust the carrying amount of the liability by an offsetting amount.

815-25-55-44 Amounts determined using the shortcut method and the facts in this Example will match the amounts in paragraph 815-25-55-48 even though the shortcut does not involve explicitly amortizing the hedge accounting adjustments on the debt. That is, the quarterly adjustments of the debt and explicit amortization of previous adjustments will have the same net effect on earnings as the shortcut method.

815-25-55-45 A slightly different shortcut method for interest rate swaps used as cash flow hedges is illustrated in Example 6 (see paragraph 815-30-55-24).

815-25-55-46 On July 1, 20X1, Entity ABC borrows \$1,000,000 to be repaid on June 30, 20X3. On that same date, Entity ABC also enters into a two-year receive-fixed, pay-variable interest rate swap. Entity ABC designates the interest rate swap as a hedge of the changes in the fair value of the fixed-rate debt attributable to

changes in the designated **benchmark interest rate**. Entity ABC designates changes in **London Interbank Offered Rate (LIBOR) swap rates** as the benchmark interest rate in hedging interest rate risk. The terms of the interest rate swap and the debt are as follows.

	<u>Interest Rate Swap</u>	<u>Fixed-Rate Debt</u>
Trade date and borrowing date ^(a)	July 1, 20X1	July 1, 20X1
Termination date and maturity date	June 30, 20X3	June 30, 20X3
Notional amount and principal amount	\$1,000,000	\$1,000,000
Fixed interest rate ^(a)	6.41%	6.41%
Variable interest rate	3-month USD LIBOR	Not applicable
Settlement dates and interest payment dates ^(a)	End of each calendar quarter	End of each calendar quarter
Reset dates	End of each calendar quarter through March 31, 20X3	Not applicable

(a) These terms need not match for the assumption of ~~no ineffectiveness~~ perfect effectiveness to be appropriate. (See paragraphs 815-20-25-102 through 25-110.)

815-25-55-47 The USD LIBOR rates that are in effect at inception of the hedging relationship and at each of the quarterly reset dates are assumed to be as follows.

<u>Reset Date</u>	<u>3-Month LIBOR Rate</u>
7/1/X1	6.41%
9/30/X1	6.48%
12/31/X1	6.41%
3/31/X2	6.32%
6/30/X2	7.60%
9/30/X2	7.71%
12/31/X2	7.82%
3/31/X3	7.42%

815-25-55-48 The following table summarizes the fair values of the debt and the interest rate swap at each quarter end, the details of the changes in the fair values during each quarter (including accrual and payment of interest, the effect of changes in rates, and level-yield amortization of hedge accounting adjustments), the expense for each quarter, and the net cash payments for each quarter. The calculations of fair value of both the debt and the interest rate swap are made using LIBOR. (A discussion of the appropriate discount rate appears in paragraph 815-20-25-111.)

	Fixed-Rate Debt	Interest Rate Swap	Expense	Net Payment
July 1, 20X1	\$ (1,000,000)	\$ -		
Interest accrued	(16,025)	-	\$ (16,025)	
Payments (receipts)	16,025	-		\$ 16,025
Effect of change in rates	1,149	(1,149)	-	
September 30, 20X1	(998,851)	(1,149)	<u>\$ (16,025)</u>	<u>\$ 16,025</u>
Interest accrued	(16,025)	(19)	\$ (16,044)	
Payments (receipts)	16,025	175		\$ 16,200
Amortization of basis adjustments	(156)	-	(156)	
Effect of change in rates	(993)	993	-	
December 31, 20X1	(1,000,000)	-	<u>\$ (16,200)</u>	<u>\$ 16,200</u>
Interest accrued	(16,025)	-	\$ (16,025)	
Payments (receipts)	16,025	-		\$ 16,025
Amortization of basis adjustments	-	-	-	
Effect of change in rates	(1,074)	1,074	-	
March 31, 20X2	(1,001,074)	1,074	<u>\$ (16,025)</u>	<u>\$ 16,025</u>
Interest accrued	(16,025)	17	\$ (16,008)	
Payments (receipts)	16,025	(225)		\$ 15,800
Amortization of basis adjustments	208	-	208	
Effect of change in rates	12,221	(12,221)	-	
June 30, 20X2	(988,645)	(11,355)	<u>\$ (15,800)</u>	<u>\$ 15,800</u>
Interest accrued	(16,025)	(216)	\$ (16,241)	
Payments (receipts)	16,025	2,975		\$ 19,000
Amortization of basis adjustments	(2,759)	-	(2,759)	
Effect of change in rates	789	(789)	-	
September 30, 20X2	(990,615)	(9,385)	<u>\$ (19,000)</u>	<u>\$ 19,000</u>
Interest accrued	(16,025)	(181)	\$ (16,206)	
Payments (receipts)	16,025	3,250		\$ 19,275
Amortization of basis adjustments	(3,069)	-	(3,069)	
Effect of change in rates	532	(532)	-	
December 31, 20X2	(993,152)	(6,848)	<u>\$ (19,275)</u>	<u>\$ 19,275</u>
Interest accrued	(16,025)	(134)	\$ (16,159)	
Payments (receipts)	16,025	3,525		\$ 19,550
Amortization of basis adjustments	(3,391)	-	(3,391)	
Effect of change in rates	(978)	978	-	
March 31, 20X3	(997,521)	(2,479)	<u>\$ (19,550)</u>	<u>\$ 19,550</u>
Interest accrued	(16,025)	(46)	\$ (16,071)	
Payments (receipts)	1,016,025	2,525		\$ 1,018,550
Amortization of basis adjustments	(2,479)	-	(2,479)	
June 30, 20X3	<u>\$ -</u>	<u>\$ -</u>	<u>\$ (18,550)</u>	<u>\$ 1,018,550</u>

815-25-55-49 The preceding table demonstrates two important points that explain why the shortcut method described in paragraphs 815-25-55-43 through 55-45 produces the same results as the computation in the preceding table if ~~there is no ineffectiveness in the hedging relationship~~ the hedge is perfectly effective:

- In every quarter, the effect of changes in rates on the interest rate swap completely offsets the effect of changes in rates on the debt. That is as expected because the hedge is perfectly effective ~~there is no ineffectiveness~~.

- b. In every quarter except the last when the principal is repaid, the expense equals the cash payment.

815-25-55-50 The following table illustrates the computation of interest expense using the shortcut method described in paragraphs 815-25-55-43 through 55-45. The results are the same as the results computed in the preceding table.

Quarter Ended	(a) Difference between Fixed Rates	(b) Variable Rate on Swap	(c) Sum (a) + (b)	(d) Debt's Principal Amount	(e) Interest Expense ([c] × [d]) ÷ 4
September 30, 20X1	0.00%	6.41%	6.41%	\$ 1,000,000	\$ 16,025
December 31, 20X1	0.00%	6.48%	6.48%	1,000,000	16,200
March 31, 20X2	0.00%	6.41%	6.41%	1,000,000	16,025
June 30, 20X2	0.00%	6.32%	6.32%	1,000,000	15,800
September 30, 20X2	0.00%	7.60%	7.60%	1,000,000	19,000
December 31, 20X2	0.00%	7.71%	7.71%	1,000,000	19,275
March 31, 20X3	0.00%	7.82%	7.82%	1,000,000	19,550
June 30, 20X3	0.00%	7.42%	7.42%	1,000,000	18,550

815-25-55-51 As stated in the introduction to this Example, a flat yield curve is assumed for simplicity. An upward-sloping yield curve would have made the computations more complex. Paragraph 815-25-55-47 would have shown different interest rates for each quarterly repricing date, and the present value of each future payment would have been computed using a different rate (as described in paragraph 815-25-55-41). However, the basic principles are the same. As long as ~~there is no ineffectiveness in the hedging relationship meets the criteria for the shortcut method, perfect effectiveness can be assumed, the shortcut method is appropriate.~~

815-25-55-52 In this Example of a fair value hedge of fixed-rate interest-bearing debt, it is assumed that Entity ABC elects to immediately begin amortizing the adjustments of the carrying amount of the fixed-rate debt while the hedge is still in place. ~~If Because~~ the change in fair value of the interest rate swap attributable to the passage of time is recognized as interest expense by Entity ABC, the amounts recorded as expenses in the table in paragraph 815-25-55-48 would be eligible for capitalization under Subtopic 835-20.

> > Example 9: Fair Value Hedge of the LIBOR Swap Rate in a \$100,000 BBB-Quality 5-Year Fixed-Rate Noncallable Note

815-25-55-53 This Example illustrates one method that could be used pursuant to paragraph 815-20-25-12(f)(2) in determining the hedged item's change in fair value attributable to changes in the benchmark interest rate. Other methods could be used in determining the hedged item's change in fair value attributable to changes in the benchmark interest rate as long as those methods meet the criteria in that paragraph. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there

are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-25-55-54 On January 1, 20X0, Entity GHI issues at par a \$100,000 BBB-quality 5-year fixed-rate noncallable debt instrument with an annual 10 percent interest coupon. On that date, Entity GHI enters into a 5-year interest rate swap based on the LIBOR swap rate and designates it as the hedging instrument in a fair value hedge of the \$100,000 liability. Under the terms of the interest rate swap, Entity GHI will receive fixed interest at 7 percent and pay variable interest at LIBOR. The variable leg of the interest rate swap resets each year on December 31 for the payments due the following year. This Example has been simplified by assuming that the interest rate applicable to a payment due at any future date is the same as the rate for a payment at any other date (that is, the yield curve is flat). During the hedge period, the gain or loss on the interest rate swap will be recorded in earnings. The Example assumes that immediately before the interest rate on the variable leg resets on December 31, 20X0, the LIBOR swap rate increased by 50 basis points to 7.50 percent, and the change in fair value of the interest rate swap for the period from January 1 to December 31, 20X0, is a loss in value of \$1,675.

815-25-55-55 Under this method, the change in a hedged item's fair value attributable to changes in the benchmark interest rate for a specific period is determined as the difference between two present value calculations that use the remaining cash flows as of the end of the period that exclude or include, respectively, and reflect in the discount rate the effect of the changes in the benchmark interest rate during the period. ~~The discount rates used for those present value calculations would be, respectively:~~

- a. Subparagraph superseded by Accounting Standards Update No. 2017-12. The discount rate equal to the market interest rate for that hedged item at the inception of the hedge adjusted (up or down) for changes in the benchmark rate (designated as the interest rate risk being hedged) from the inception of the hedge to the beginning date of the period for which the change in fair value is being calculated
 - b. Subparagraph superseded by Accounting Standards Update No. 2017-12. The discount rate equal to the market interest rate for that hedged item at the inception of the hedge adjusted (up or down) for changes in the designated benchmark rate from the inception of the hedge to the ending date of the period for which the change in fair value is being calculated.
- [Content moved to paragraph 815-25-55-57]**

815-25-55-56 Both present value calculations are computed using the estimated future cash flows for the hedged item ~~(which item, which typically would be either its remaining contractual coupon cash flows), flows or the LIBOR benchmark rate component of the remaining contractual coupon cash flows determined at hedge inception as illustrated by the following Cases:~~

- a. Using the full contractual coupon cash flows (Case A)
- b. Using the LIBOR benchmark rate component of the contractual coupon cash flows (Case B).

815-25-55-56A This Example illustrates two approaches for computing the change in fair value of the hedged item attributable to changes in the benchmark interest rate. This Subtopic does not specify provide specific guidance on the discount rate that must be used to calculate the change in fair value of the hedged item in the calculation. [Content amended as shown and moved from paragraph 815-25-55-57]

815-25-55-56B In Cases A and B in this Example, Entity GHI presents the total change in the fair value of the hedging instrument (that is, the interest accruals and all other changes in fair value) in the same income statement line item (in this case, interest expense) that is used by Entity GHI to present the earnings effect of the hedged item before applying hedge accounting in accordance with paragraph 815-20-45-1A.

> > > Case A: Using the Full Contractual Coupon Cash Flows

815-25-55-57 This Subtopic does not provide specific guidance on the discount rate that must be used in the calculation. [Content amended and moved to paragraph 815-25-55-56A] In this Case, assume Entity GHI elected to calculate the change in the fair value of the hedged item attributable to interest rate risk on the basis of the full contractual coupon cash flows of the hedged item. Accordingly, both present value calculations in accordance with paragraph 815-25-55-55 are computed using the remaining contractual coupon cash flows as of the end of the period and the discount rate that reflects the change in the designated benchmark interest rate during the period. However, the The method chosen by Entity GHI and described in this Example in this Case requires that the discount rate be based on the market interest rate for the hedged item at the inception of the hedging relationship. The discount rates used for those present value calculations would be, respectively:

- a. The discount rate equal to the market interest rate for that hedged item at the inception of the hedge adjusted (up or down) for changes in the benchmark rate (designated as the interest rate risk being hedged) from the inception of the hedge to the beginning date of the period for which the change in fair value is being calculated
- b. The discount rate equal to the market interest rate for that hedged item at the inception of the hedge adjusted (up or down) for changes in the designated benchmark rate from the inception of the hedge to the ending date of the period for which the change in fair value is being calculated. **[Content moved from paragraph 815-25-55-55]**

815-25-55-58 Entity GHI elected to subsequently assess hedge effectiveness on a quantitative basis. In Entity GHI's quarterly assessments of hedge effectiveness for each of the first three quarters of year 20X0 in this Example, there was zero change in the hedged item's fair value attributable to changes in the benchmark interest rate because there was no change in the LIBOR swap rate. However, in the assessment for the fourth quarter 20X0, the discount rate for the beginning of the period is 10 percent (the hedged item's original market interest rate with an adjustment of zero), and the discount rate for the end of the period is 10.50 percent (the hedged item's original market interest rate adjusted for the change during the period in the LIBOR swap rate [+ 0.50 percent]).

December 31, 20X0

Calculate the present value using the beginning-of-period discount rate of 10 percent:

\$10,000pmt, 10%i, 4n, PV =	\$ 31,699 (interest payments)
\$100,000fv, 10%i, 4n, PV =	\$ 68,301 (principal payment)
Total present value	<u>\$100,000</u>

815-25-55-59 Calculate the present value using the end-of-period discount rate of 10.50 percent (that is, the beginning-of-period discount rate adjusted for the change during the period in the LIBOR swap rate of 50 basis points).

\$10,000pmt, 10.50%i, 4n, PV =	\$ 31,359 (interest payments)
\$100,000fv, 10.50%i, 4n, PV =	\$ 67,073 (principal payment)
Total present value	<u>\$ 98,432</u>

815-25-55-60 The change in fair value of the hedged item attributable to the change in the benchmark interest rate is \$100,000 – \$98,432 = \$1,568 (the fair value decrease in the liability is a gain on debt).

815-25-55-61 When the change in fair value of the hedged item (\$1,568 gain) attributable to the risk being hedged is compared with the change in fair value of the hedging instrument (\$1,675 loss), a mismatch ineffectiveness of \$107 results. ~~That ineffectiveness results that~~ will be reported in earnings, because both changes in fair value are recorded in earnings. The change in the fair value of the hedging instrument will be presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A.

> > > Case B: Using the LIBOR Benchmark Rate Component of the Contractual Coupon Cash Flows

815-25-55-61A In this Case, assume Entity GHI elected to calculate the change in the fair value of the hedged item attributable to interest rate risk on the basis of the benchmark rate component of the contractual coupon cash flows determined at hedge inception. Accordingly, both present value calculations in accordance with paragraph 815-25-55-55 are computed using the remaining benchmark rate component of contractual coupon cash flows as of the end period and the discount rate that reflects the change in the designated benchmark rate during the period. The discount rates used by Entity GHI in this Case would be, respectively:

- a. The benchmark rate (designated as the interest rate risk being hedged) as of the beginning date of the period for which the change in fair value is being calculated
- b. The designated benchmark rate as of the ending date of the period for which the change in fair value is being calculated.

815-25-55-61B Entity GHI elected to subsequently assess hedge effectiveness on a quantitative basis. In Entity GHI's quarterly assessments of hedge effectiveness for each of the first three quarters of year 20X0, there was no change in the hedged item's fair value attributable to changes in the benchmark interest rate because there was no change in the LIBOR swap rate. However, in the assessment for the fourth quarter 20X0, the discount rate for the beginning of the period is 7 percent, and the discount rate for the end of the period is 7.50 percent reflecting the change during the period in the LIBOR swap rate. The change in fair value of the hedged item attributable to the change in the benchmark interest risk for the period January 1, 20X0, to December 31, 20X0, is a gain of \$1,675, calculated as follows.

[For ease of readability, the new table is not underlined.]

December 31, 20X0

Calculate the present value using the beginning-of-period benchmark interest rate:

\$7,000pmt, 7%i, 4n, PV =	\$	23,710	(benchmark component of coupon payments)
\$100,000fv, 7%i, 4n, PV =		76,290	(principal payment)
Total present value		100,000	

Calculate the present value using the end-of-period benchmark interest rate:

\$7,000pmt, 7.50%i, 4n, PV =		23,445	(benchmark component of coupon payments)
\$100,000fv, 7.50%i, 4n, PV =		74,880	(principal payment)
Total present value		98,325	
Change in value	\$	1,675	

815-25-55-61C Because the change in fair value of the hedged item (\$1,675 gain) attributable to the risk being hedged is the same as the change in fair value of the

hedging instrument (\$1,675 loss), there is perfect offset and, therefore, a zero net earnings effect.

> > Example 10: Fair Value Hedge of a Firm Commitment Denominated in a Foreign Currency with a Forward to Purchase a Different Foreign Currency

815-25-55-62 This Example illustrates application of the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 to a fair value hedge of a **firm commitment** to purchase an asset for a price denominated in a foreign currency. In this Example, the hedging instrument and the firm commitment are denominated in different foreign currencies. Consequently, although the hedge is highly effective at achieving offsetting changes in fair value, the hedge is not perfectly effective, and there will be an earnings effect ~~ineffectiveness is recognized immediately in earnings.~~ (The entity in the Example could have designed a perfectly effective hedge ~~with no ineffectiveness~~ by using a hedging instrument denominated in the same foreign currency as the firm commitment with terms that match the appropriate terms in the firm commitment.) For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-25-55-63 Entity MNO's functional currency is the U.S. dollar (USD). On February 3, 20X7, Entity MNO enters into a firm commitment to purchase a machine for delivery on May 1, 20X7. The price of the machine will be 270,000 ~~Dutch guilders~~ Swiss francs (NLG (CHF 270,000)). Also on February 3, 20X7, Entity MNO enters into a forward contract to purchase 240,000 Euros (EUR 240,000) on May 1, 20X7. Entity MNO will pay USD 0.6125 per EUR 1 (a total of USD 147,000), which is the current forward rate for an exchange on May 1, 20X7. Entity MNO designates the forward contract as a hedge of its risk of changes in the fair value of the firm commitment resulting from changes in the USD-CHF ~~NLG~~ forward exchange rate.

815-25-55-64 Entity MNO will assess effectiveness by comparing the overall changes in the fair value of the forward contract to the changes in fair value in USD of the firm commitment due to changes in USD-CHF ~~NLG~~ forward exchange rates. Entity MNO expects the forward contract to be highly effective as a hedge because all of the following conditions exist:

- EUR 240,000 is approximately equal to CHF ~~NLG~~ 270,000 at the May 1, 20X1, forward exchange rate in effect on February 3, 20X7.
- Settlement of the forward contract and the firm commitment will occur on the same date.
- In recent years, changes in the value in USD of EUR over three-month periods have been highly correlated with changes in the value in USD of CHF ~~NLG~~ over those same periods.

815-25-55-65 ~~Ineffectiveness will result from~~ Although the hedging relationship has been determined to be highly effective at achieving offsetting changes in fair value, the hedge will not be perfectly effective and the difference between changes in the USD equivalent of EUR 240,000 (the notional amount of the forward contract) and changes in the USD equivalent of CHF NLG 270,000 (the amount to be paid for the ~~machine~~ machine) will affect earnings. The difference between the **spot rate** and the forward exchange rate is not excluded from the assessment of hedge effectiveness ~~hedging relationship~~ because changes in the fair value of the firm commitment are being measured using forward exchange rates. Therefore, the entire change in the fair value of the hedging instrument will be presented in earnings in the same income statement line item as the earnings effect of the hedged item. If the hedged item were a foreign-currency-denominated available-for-sale debt security instead of a firm commitment, Topic 830 would have required its carrying value to be measured using the spot exchange rate. ~~Therefore In that case,~~ the spot-forward difference would have been recognized immediately currently in earnings in the same income statement line item as the earnings effect of the hedged item if it was included in either ~~because it represented ineffectiveness or because it was excluded from~~ the assessment of effectiveness. The spot-forward difference also may be excluded from the assessment of effectiveness and accounted for through either an amortization approach or a mark-to-market approach in accordance with paragraph 815-20-25-83A or paragraph 815-20-25-83B.

815-25-55-66 The forward exchange rates in effect on certain key dates are assumed to be as follows.

<u>Date</u>	<u>USD-EUR Forward Exchange Rate for Settlement on 5/1/X7</u>	<u>USD-CHF NLG Forward Exchange Rate for Settlement on 5/1/X7</u>
Inception of the hedge—2/3/X7	USD 0.6125 = EUR 1	USD 0.5454 = <u>CHF NLG 1</u>
Quarter end—3/31/X7	USD 0.5983 = EUR 1	USD 0.5317 = <u>CHF NLG 1</u>
Machine purchase—5/1/X7	USD 0.5777 = EUR 1	USD 0.5137 = <u>CHF NLG 1</u>

815-25-55-67 The USD equivalent and changes in the USD equivalent of the forward contract and the firm commitment, the changes in fair value of the forward contract and the firm commitment, and the ~~ineffectiveness~~ earnings effect of the hedge on those same key dates are shown in the following table. A 6 percent discount rate is used in this Example.

	2/3/X7	3/31/X7	5/1/X7
Forward contract			
USD-EUR forward exchange rate for settlement on May 1, 20X7	USD 0.61	USD 0.60	USD 0.58
Units of currency (EUR)	× 240,000	× 240,000	× 240,000
Forward price of EUR 240,000 in USD	147,000	143,592	138,648
Contract price in USD	(147,000)	(147,000)	(147,000)
Difference	USD -	USD (3,408.00)	USD (8,352.00)
Fair value (present value of the difference)	USD -	USD (3,391.00)	USD (8,352.00)
Change in fair value during the period		USD (3,391.00)	USD (4,961.00)
Firm commitment			
USD-CHF NLG forward exchange rate for settlement on May 1, 20X7	USD 0.55	USD 0.53	USD 0.51
Units of currency (CHF) (NLG)	× 270,000	× 270,000	× 270,000
Forward price of CHF NLG 270,000 in USD	(147,258)	(143,559)	(138,699)
Initial forward price in USD	147,258	147,258	147,258
Difference	USD -	USD 3,699.00	USD 8,559.00
Fair value (present value of the difference)	USD -	USD 3,681.00	USD 8,559.00
Change in fair value during the period		USD 3,681.00	USD 4,878.00
Hedge ineffectiveness (difference Difference between changes in fair values of the forward contract denominated in EUR and the firm commitment denominated in CHF NLG)		USD 290.00	USD (83.00)

815-25-55-68 This Subtopic requires that Entity MNO recognize immediately currently in earnings all changes in fair values of the forward contract. Because Entity MNO is hedging the risk of changes in fair value of the firm commitment attributable to changes in the forward exchange rates, this Subtopic also requires recognizing those changes immediately currently in earnings. Section 815-20-45 requires that those changes be presented in earnings in the same income statement line item as the earnings effect of the hedged item.

815-25-55-69 On May 1, 20X7, Entity MNO fulfills the firm commitment to purchase the machine and settles the forward contract. The entries illustrating fair value hedge accounting for the hedging relationship and the purchase of the machine are summarized in the following table.

	Debit (Credit)				
	Cash	Firm Commitment	Forward Contract	Machine	Earnings
March 31, 20X7					
Recognize change in fair value of firm commitment		USD 3,681			USD (3,681)
Recognize change in fair value of forward contract			USD (3,391)		3,391
					(290)
April 30, 20X7					
Recognize change in fair value of firm commitment		4,878			(4,878)
Recognize change in fair value of forward contract			(4,961)		4,961
					83
May 1, 20X7					
Recognize settlement of forward contract	USD (8,352)		8,352		
Recognize purchase of machine	(138,699)	(8,559)		USD 147,258	
Total	USD (147,051)	USD -	USD -	USD 147,258	USD (207)

815-25-55-70 To simplify this Example and focus on the effects of the hedging relationship, other amounts that would be involved in the purchase of the machine by Entity MNO (for example, shipping costs and installation costs) have been ignored.

815-25-55-71 The effect of the hedge is to recognize the machine at its price in CHF NLG (CHF ~~NLG~~ 270,000) translated at the forward rate in effect at the inception of the hedge (USD 0.5454 per ~~NLG~~ CHF 1).

> > Example 11: Fair Value Hedge of the LIBOR Swap Rate in a \$100 Million A1-Quality 5-Year Fixed-Rate Noncallable Debt

815-25-55-72 This Example illustrates application of the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 to a fair value hedge of the LIBOR swap rate in a \$100 million A1-quality 5-year fixed-rate noncallable debt. Assume that an entity elected to calculate the change in the fair value of the hedged item attributable to LIBOR interest rate risk using the full contractual coupon cash flows of the hedged item.

815-25-55-73 On April 3, 20X0, Global Tech issues at par a \$100 million A1-quality 5-year fixed-rate noncallable debt instrument with an annual 8 percent interest coupon payable semiannually. On that date, Global Tech enters into a 5-year interest rate swap based on the LIBOR swap rate and designates it as the hedging instrument in a fair value hedge of the \$100 million liability. Under the terms of the interest rate swap, Global Tech will receive a fixed interest rate at 8 percent and pay variable interest at LIBOR plus 78.5 basis points (current LIBOR 6.29 percent) on a notional amount of \$101,970,000 (semiannual settlement and interest reset dates). A duration-weighted hedge ratio was used to calculate the notional amount

of the interest rate swap necessary to offset the debt's fair value changes attributable to changes in the LIBOR swap rate.

815-25-55-74 This Example has the following assumptions:

- a. PV01 debt = 4.14
- b. PV01 interest rate swap = 4.06
- c. Hedge ratio = PV01 debt / PV01 interest rate swap = 4.14/4.06 = 1.0197
- d. Interest rate swap notional = 1.0197 × \$100 million = \$101,970,000.
- e. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-25-55-75 The Example assumes that the LIBOR swap rate increased 100 basis points to 9 7.29 percent on June 30, 20X0. The change in fair value of the interest rate swap for the period from April 3 to June 30, 20X0, is a loss of \$4,016,000. The change in fair value of the debt attributable to changes in the benchmark interest rate for the period April 3 to June 30, 20X0, is calculated as follows.

Period	Principal Balance	Coupon Rate	Cash Flow – Interest	Cash Flow – Principal	Present Value
0.5	\$ 100,000,000	0.08	2,000,000	-	1,956,464
1.5	\$ 100,000,000	0.08	4,000,000	-	3,744,429
2.5	\$ 100,000,000	0.08	4,000,000	-	3,583,185
3.5	\$ 100,000,000	0.08	4,000,000	-	3,428,885
4.5	\$ 100,000,000	0.08	4,000,000	-	3,281,230
5.5	\$ 100,000,000	0.08	4,000,000	-	3,139,933
6.5	\$ 100,000,000	0.08	4,000,000	-	3,004,721
7.5	\$ 100,000,000	0.08	4,000,000	-	2,875,331
8.5	\$ 100,000,000	0.08	4,000,000	-	2,751,513
9.5	\$ 100,000,000	0.08	4,000,000	100,000,000	68,458,689
Present value					<u>96,224,380</u>

815-25-55-76 As of June 30, 20X0, 9.5 periods remain and the cash flows are discounted at 9 percent, determined as the initial 8-percent yield plus a 100 basis point increase attributable to the 100 basis point increase in the LIBOR swap rate. The accrual for the first quarter interest was excluded. The following journal entries illustrate the interest rate swap and debt fair value changes, attributable to changes in the LIBOR swap rate, excluding accruals.

	Debit	Credit
Debt	\$ 3,775,620	
Earnings Interest expense		\$ 3,775,620
Earnings Interest expense	4,016,000	
Swap liability		4,016,000

815-25-55-77 The net earnings effect impact of the hedge hedging relationship was \$240,380 because of the mismatch between the change in the fair value of the hedging instrument and the change in fair value of the hedged item. In accordance with paragraph 815-20-45-1A, Global Tech presents the entire change in the fair value of the hedging instrument (including interest accruals and all other changes in fair value) in the same income statement line item (in this case, interest expense) that is used by Global Tech to present the earnings effect of the hedged item before applying hedge accounting due to some imprecision in the calculated hedge ratio.

>> Example 12: Fair Value Hedge of a Fixed-Rate Foreign-Currency-Denominated Loan in Which All of the Variability in the Functional-Currency-Equivalent Cash Flows Is Not Eliminated (Fixed to Variable Scenario)

815-25-55-78 Paragraph superseded by Accounting Standards Update No. 2017-12. This Example illustrates application of the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 to a fair value hedge of a fixed-rate foreign-currency-denominated loan in which all of the variability in the functional-currency-equivalent cash flows is not eliminated.

815-25-55-79 Paragraph superseded by Accounting Standards Update No. 2017-12. Entity ABC's functional currency is the U.S. dollar (USD). On January 3, 200X, Entity ABC borrows 100 million fixed-rate Euro (EUR) at a yield to maturity of 5.68 percent. The loan has a term of 5 years and pays an annual coupon of 5.68 percent. This yield at inception is equivalent to Euribor plus 0.52 percent or (on a swapped basis) to USD LIBOR plus 0.536 percent.

815-25-55-80 Paragraph superseded by Accounting Standards Update No. 2017-12. Also on January 3, 200X, Entity ABC enters into a 5-year cross-currency swap in which it will receive fixed EUR at a rate of 5.68 percent on EUR 100 million and pay variable USD at USD LIBOR plus 0.536 percent on USD 102 million. There will be a final exchange of principal on maturity of the contract. Both the debt and the cross-currency swap will pay annual coupons on December 31. Entity ABC designates the cross-currency swap as a fair value hedge of the changes in the fair value of the loan due to both interest and exchange rates.

815-25-55-81 Paragraph superseded by Accounting Standards Update No. 2017-12. The spot foreign-exchange rates for EUR/USD, LIBOR flat EUR swap rates, EUR/USD basis swap spreads and 1-year USD LIBOR on December 31 each year over the life of the hedge were as follows.

Years	0	1	2	3	4	5
Spot foreign exchange	1.0200	1.0723	1.0723	1.1273	1.1851	1.2458
EUR swap rate	5.160%	5.151%	5.040%	4.854%	4.480%	N/A
Basis swap spread	(0.02)%	(0.02)%	(0.02)%	(0.02)%	(0.02)%	N/A
1-year USD LIBOR	6.00%	5.50%	6.00%	6.50%	7.00%	N/A

815-25-55-82 Paragraph superseded by Accounting Standards Update No. 2017-12. The changes in fair value of the debt attributable to changes in both EUR interest rates and spot foreign exchange rates, and the values and changes in value (in USD) of the receive fixed EUR, pay variable USD swap, are shown in the following table.

(in USD millions)						
A Spot Foreign Exchange	—1.0200	—1.0723	—1.0723	—1.1273	—1.1851	—1.2458
B Fair value of debt (in EUR)	(100.000)	(100.032)	(100.322)	(100.567)	(100.647)	—
C Debt at spot (in USD) (A × B)	(102.000)	(107.265)	(107.575)	(113.366)	(119.274)	—
D Cumulative change on debt	—	(5.265)	(5.575)	(11.366)	(17.274)	—
E Change in period	—	(5.265)	(0.310)	(5.791)	(5.908)	—17.274
F EUR fixed to USD floating swap	—	—5.333	—5.642	—11.472	—17.357	—
G Change in period	—	—5.333	—0.310	—6.830	—6.885	(17.357)

815-25-55-83 Paragraph superseded by Accounting Standards Update No. 2017-12. As a fair value hedge, changes in the value of the debt and the cross-currency swap are recognized immediately in earnings. The income statement effect, including interest expense, is set out in the following table.

Years	0	1	2	3	4	5
Interest expense ^(a)	—	—(6.667)	—(6.157)	—(6.667)	—(7.177)	—(7.687)
Change in value of debt (from E of preceding table)	—	—(5.265)	—(0.310)	—(5.791)	—(5.908)	—17.274
Hedge gain or loss (from G of preceding table)	—	—5.333	—0.310	—5.830	—6.885	—(17.357)
Net	—	—(6.699)	—(6.157)	—(6.628)	—(7.200)	—(17.770)

(a) The interest expense is calculated based on USD LIBOR plus .536 percent on USD 102 million. The fixed EUR interest expense remeasured into the USD functional currency is adjusted by the net cash payment on the cross-currency swap to reflect the variable U.S. interest rate (LIBOR + .536 percent) inherent in the cross-currency swap.

> > Example 13: Definition of Firm Commitment

815-25-55-84 This Example illustrates a circumstance in which statutory remedies for default constitute a disincentive for nonperformance in applying the definition of a firm commitment. Entity A enters into an agreement to purchase 4,000 barrels of a common solvent from a chemical entity at \$200 per barrel on June 1, 2000. The provisions of the agreement do not include a specific disincentive for nonperformance that is sufficiently large to make performance probable. However, the laws of the legal jurisdiction to which the agreement is subject provide a disincentive for nonperformance if Entity A does not take delivery of the barrels pursuant to the agreement. The solvent is not **readily convertible to cash**. Therefore, because the governing legal jurisdiction provides statutory rights to pursue remedies for default equivalent to the damages suffered, the agreement

includes a disincentive for nonperformance that is sufficiently large to make performance probable for purposes of applying the definition of a firm commitment.

> > Example 14: Interaction with Loan Impairment

815-25-55-85 This Example illustrates the application of paragraph 815-25-35-11 involving the interaction of hedge accounting and loan impairment accounting. The following Cases also illustrate the effect of the two approaches to calculate the change in the fair value of the hedged item attributable to interest rate risk discussed in paragraph 815-25-35-13 on that interaction, as follows:

- a. Using the full contractual coupon cash flows (Case A)
- b. Using the benchmark rate component of the contractual coupon cash flows (Case B).

In addition, amend the following pending content for paragraph 815-25-55-85, with a link to transition paragraph 326-10-65-1:

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

Editor's Note: The content of paragraph 815-25-55-85 will be amended upon transition, together with a change in the heading noted below.

> > Example 14: Interaction with Measurement of Credit Losses

815-25-55-85 This Example illustrates the application of paragraph 815-25-35-11 involving the interaction of hedge accounting and measurement of credit losses in Subtopic 326-20 on financial instruments measured at amortized cost. The following Cases also illustrate the effect of the two approaches to calculate the change in the fair value of the hedged item attributable to interest rate risk discussed in paragraph 815-25-35-13 on that interaction, as follows:

- a. Using the full contractual coupon cash flows (Case A)
- b. Using the benchmark rate component of the contractual coupon cash flows (Case B).

815-25-55-86 Entity A formally documents a qualifying fair value hedge (for fair value changes attributable to changes in the designated benchmark interest rate) between a fixed-rate loan receivable from Entity B and an interest rate swap. The 5-year, fixed-rate loan to Entity B has a principal amount of \$1,000,000 payable at maturity and interest payable annually at a 10 percent rate. For simplicity, commissions and most other transaction costs, initial margin, and income taxes

are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship. ~~One year after inception of the hedging relationship, the change in the hedged item's fair value attributable to changes in the LIBOR swap rate (the designated benchmark interest rate) is a gain of \$16,022. (See row B in the table in paragraph 815-25-55-90, which presents calculations—at the end of the first year of the loan's term—of the net present value of contractual cash flows based on the loan's original effective interest rate adjusted for a 50 basis point decrease in the LIBOR swap rate.)~~ [Content amended and moved to paragraph 815-25-55-88A]

815-25-55-87 ~~In addition, one~~ One year after inception of the hedging relationship, both of the following conditions exist:

- a. ~~Subparagraph superseded by Accounting Standards Update No 2017-12. The market interest rates for debtors of Entity B's original credit sector have decreased to 9.2 percent (50 basis points related to changes in the LIBOR swap rate and 30 basis points related to changes in sector spread).~~
- b. There has been an adverse change to Entity B's creditworthiness.
- c. The LIBOR swap rate (the designated benchmark interest rate) has decreased from 6 percent to 5.5 percent.

815-25-55-88 Assume that the repayment of the loan is not dependent on the underlying collateral. In applying the requirements of Subtopic 310-10 to the loan, Entity A determines that the loan is impaired and that the present value of expected future cash flows discounted at the loan's effective interest rate at inception of the loan is \$930,000. (See row C in the table in paragraph 815-25-55-90, which presents calculations—at the end of the first year of the loan's term—of the net present value of current estimates of expected future cash flows based on the loan's original effective interest rate.)

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

815-25-55-88 Assume that the repayment of the loan is not dependent on the underlying collateral. In applying the requirements of Subtopic 326-20 to the loan, Entity A evaluates the loan for credit losses on an individual basis because it does not have similar risk characteristics with other loans in the portfolio and uses a discounted cash flow approach. Entity A determines that the present value of expected future cash flows discounted at the loan's effective interest rate at inception of the loan is \$930,000. (See row C in the table in paragraph 815-25-55-90, which presents calculations—at the end of the first year of the loan's term—of the net present value of current estimates of expected future cash flows based on the loan's original effective interest rate.)

> > > Case A: Using the Full Contractual Coupon Cash Flows

815-25-55-88A In this Case, assume that the entity elected to calculate fair value changes in the hedged item attributable to interest rate risk using the full contractual coupon cash flows of the hedged item. One year after inception of the hedging relationship, the change in the hedged item's fair value attributable to changes in the LIBOR swap rate (the designated benchmark interest rate) is a gain of \$16,022. (See row B in the table in paragraph 815-25-55-90, which presents calculations—at the end of the first year of the loan's term—of the net present value of contractual cash flows based on the loan's original effective interest rate adjusted for a 50 basis point decrease in the LIBOR swap rate.) **[Content amended as shown and moved from paragraph 815-25-55-86]**

815-25-55-89 After adjusting the carrying amount of the hedged loan by \$16,022 (pursuant to paragraph 815-25-35-1(b)) for the increase in the hedged item's fair value attributable to changes in the benchmark interest rate, Entity A should apply the guidance in Section 310-10-35 by doing both of the following:

- a. Comparing the recorded investment of the loan after the effect of the fair value hedge, or \$1,016,022, to the \$944,901 present value of expected future cash flows discounted using the rate that reflects the rate of return implicit in the loan after adjusting the carrying amount of the hedged loan pursuant to paragraph 815-25-35-1(b) (that is, 9.5 percent)
- b. Recognizing an impairment by creating a valuation allowance (with the offsetting entry charged to expense) for the difference of \$71,121 (\$1,016,022 – \$944,901).

In addition, amend the following pending content for paragraph 815-25-55-89, with a link to transition paragraph 326-10-65-1:

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:**

815-25-55-89 After adjusting the amortized cost basis ~~carrying amount~~ of the hedged loan by \$16,022 (pursuant to paragraph 815-25-35-1(b)) for the increase in the hedged item's fair value attributable to changes in the benchmark interest rate, Entity A should apply the guidance in Subtopic 326-20 by doing both of the following:

- a. Comparing the amortized cost basis of the loan after the effect of the fair value hedge, or \$1,016,022, to the \$944,901 present value of expected future cash flows discounted using the rate that reflects the rate of return implicit in the loan after adjusting the amortized cost basis ~~carrying~~

amount of the hedged loan pursuant to paragraph 815-25-35-1(b) (that is, 9.5 percent)

- b. Recording an allowance for credit losses (with the offsetting entry charged to expense) for the difference of \$71,121 (\$1,016,022 – \$944,901).

815-25-55-90 Following are calculations (at the end of the first year of the loan's term) of the net present value of the contractual cash flows and the creditor's best estimate of expected future cash flows based on the loan's original effective interest rate and the new implicit rate.

	Rate	Net Present Value at End of Year 1	Assumed Cash Flow in Year			
			2	3	4	5
A. Original cash flows and original effective rate	10.0%	\$ 1,000,000	\$ 100,000	\$ 100,000	\$ 100,000	\$ 1,100,000
B. Original cash flows and new implicit rate	9.5%	\$ 1,016,022	\$ 100,000	\$ 100,000	\$ 100,000	\$ 1,100,000
C. Expected future cash flows and original effective rate	10.0%	\$ 930,000	\$ 93,000	\$ 93,000	\$ 93,000	\$ 1,023,000
D. Expected future cash flows and new implicit rate	9.5%	\$ 944,901	\$ 93,000	\$ 93,000	\$ 93,000	\$ 1,023,000

> > > Case B: Using the Benchmark Rate Component of the Contractual Coupon Cash Flows

815-25-55-91 In this Case, assume that Entity A elected to calculate fair value changes in the hedged item attributable to interest rate risk using the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. One year after inception of the hedging relationship, the change in the hedged item's fair value attributable to changes in the LIBOR swap rate (the designated benchmark interest rate) is a gain of \$17,526, which is calculated as follows.

[For ease of readability, the new tables in Examples 14–17 are not underlined.]

At the beginning of the loan's term

\$60,000pmt, 6%i, 5n, 1,000,000fv, PV = \$ 1,000,000

At the end of the first year of the loan's term

\$60,000pmt, 5.5%i, 4n, 1,000,000fv, PV = 1,017,526

Change in value \$ (17,526)

815-25-55-92 After adjusting the carrying amount of the hedged loan by \$17,526 (in accordance with paragraph 815-25-35-1(b)) for the increase in the hedged item's fair value attributable to changes in the benchmark interest rate, Entity A should apply the guidance in Section 310-10-35 by doing both of the following:

- a. Comparing the recorded investment of the loan after the effect of the fair value hedge, or \$1,017,526, to the \$946,299 present value of expected future cash flows discounted using the rate that reflects the rate of return implicit in the loan after adjusting the carrying amount of the hedged loan in accordance with paragraph 815-25-35-1(b) (that is, 9.45 percent that equates the adjusted carrying amount of the loan with the present value of the contractual cash flows of the loan)
- b. Recognizing an impairment by creating a valuation allowance (with the offsetting entry charged to expense) for the difference of \$71,227 (\$1,017,526 – \$946,299).

In addition, add the following pending content for paragraph 815-25-55-92, with a link to transition paragraph 326-10-65-1:

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

815-25-55-92 After adjusting the amortized cost basis of the hedged loan by \$17,526 (in accordance with paragraph 815-25-35-1(b)) for the increase in the hedged item's fair value attributable to changes in the benchmark interest rate, Entity A should apply the guidance in Subtopic 326-20 by doing both of the following:

- a. Comparing the amortized cost basis of the loan after the effect of the fair value hedge, or \$1,017,526, to the \$946,299 present value of expected future cash flows discounted using the rate that reflects the rate of return implicit in the loan after adjusting the amortized cost basis of the hedged loan in accordance with paragraph 815-25-35-1(b) (that is, 9.45 percent that equates the adjusted amortized costs basis of the loan with the present value of the contractual cash flows of the loan)
- b. Recognizing an allowance for credit losses (with the offsetting entry charged to expense) for the difference of \$71,227 (\$1,017,526 – \$946,299).

815-25-55-93 Following are calculations (at the end of the first year of the loan's term) of the net present value of the benchmark rate component of the contractual cash flows and the creditor's best estimate of expected future cash flows based on the loan's original effective interest rate and the new implicit rate. In row B, the net present value at the end of the first year is equal to the net present value of the

benchmark rate component of the contractual coupon cash flows discounted at the 5.5 percent benchmark rate.

	Rate	Net Present Value at End of Year 1	Assumed Cash Flow in Year			
			2	3	4	5
A. Original cash flows and original effective rate	10.00%	\$1,000,000	\$100,000	\$100,000	\$100,000	\$1,100,000
B. Original cash flows and new implicit rate	9.45%	\$1,017,526	\$100,000	\$100,000	\$100,000	\$1,100,000
C. Expected future cash flows and original effective rate	10.00%	\$930,000	\$93,000	\$93,000	\$93,000	\$1,023,000
D. Expected future cash flows and new implicit rate impairment	9.45%	\$946,299	\$93,000	\$93,000	\$93,000	\$1,023,000

> > Example 15: Fair Value Hedge of Interest Rate Risk Using the Partial-Term Approach

815-25-55-94 This Example illustrates the application of paragraphs 815-20-25-12(b)(2)(ii) and 815-25-35-13B to the designation and measurement of a hedged item as a portion of the term of a financial instrument in a hedge of interest rate risk. Assume that Entity S elected to calculate fair value changes in the hedged item attributable to interest rate risk on the basis of the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception.

815-25-55-95 On January 1, 20X1, Entity S issues a noncallable, 5-year, \$100 million debt instrument with a 3 percent semiannual interest coupon. On that date, the issuer also enters into a 2-year interest rate swap with a notional amount of \$100 million. Entity S designates the swap as a fair value hedge of the fixed-rate debt attributable to interest rate risk for the first two years of its term in accordance with the guidance in paragraph 815-20-25-12(b)(2)(ii). The swap pays LIBOR and receives a fixed rate of 2 percent, with semiannual payments. The swap has a fair value of zero at inception. The designated benchmark interest rate is the LIBOR swap rate. For ease of calculation, the yield curve is assumed to be flat at the level of the current benchmark interest rate. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-25-55-96 This Example assumes that the LIBOR swap rate increased by 50 basis points to 2.5 percent on June 30, 20X1. The change in fair value of the interest rate swap for the period January 1, 20X1, to June 30, 20X1, is a loss in value of \$731,633.

815-25-55-97 In calculating the change in fair value of the debt attributable to changes in the benchmark interest rate in accordance with paragraph 815-25-35-13B, Entity S determines that the assumed term of the hedged item is two years

because it is hedging only the cash flows associated with the first two years of its debt issuance. The change in fair value of the debt attributable to changes in the benchmark interest rate for the period January 1, 20X1, to June 30, 20X1, is a gain of \$731,633, calculated as follows.

January 1, 20X1—beginning balance

\$1,000,000pmt, 1.00%i, 4n, 100,000,000fv, PV = \$ 100,000,000

June 30, 20X1—ending balance

\$1,000,000pmt, 1.25%i, 3n, 100,000,000fv, PV = 99,268,367

Change in value \$ 731,633

815-25-55-98 As of June 30, 20X1, the change in fair value of the debt attributable to the benchmark interest rate is calculated by discounting the benchmark rate component of the contractual coupon cash flows using the benchmark interest rate at June 30, 20X1 (2.5 percent annual rate and 1.25 percent for each semiannual period). The change in fair value of the debt and the change in fair value of the swap result in perfect offset in current-period earnings. In accordance with paragraph 815-20-45-1A, Entity S presents the total change in the fair value of the hedging instrument (that is, the interest accruals and all other changes in fair value) in the same income statement line item (in this case, interest expense) that is used by Entity S to present the earnings effect of the hedged item before applying hedge accounting.

815-25-55-99 Although this Example illustrates the hedged item as the first two years of interest payments associated with an existing debt instrument, paragraph 815-20-25-12(b)(2)(ii) permits one interest payment or any consecutive interest payments associated with an existing debt instrument to be designated as the hedged item.

> > Example 16: Fair Value Hedge of the LIBOR Swap Rate in a \$100 Million A1-Quality 5-Year Fixed-Rate Noncallable Debt

815-25-55-100 The following Cases illustrate application of the guidance in Sections 815-20-25, 815-20-35, and 815-25-35 to a fair value hedge of the LIBOR swap rate in a \$100 million A1-quality 5-year fixed-rate noncallable debt:

- a. Using the full contractual coupon cash flows (Case A)
- b. Using the benchmark rate component of the contractual coupon cash flows (Case B).

815-25-55-101 On July 2, 20X0, Entity XYZ issues at par a \$100 million A1-quality 5-year fixed-rate noncallable debt instrument with an annual 8 percent interest coupon payable semiannually. On that date, Entity XYZ enters into a 5-year interest rate swap based on the LIBOR swap rate and designates it as the hedging

instrument in a fair value hedge of interest rate risk of the \$100 million liability. Under the terms of the interest rate swap, Entity XYZ will receive a fixed interest rate at 8 percent and pay variable interest at LIBOR plus 200 basis points (current LIBOR 6 percent) on a notional amount of \$100 million (semiannual settlement and interest reset dates). For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship. The Example also assumes that the yield curve is flat and that the LIBOR swap rate increased 100 basis points to 7 percent on December 31, 20X0. The change in fair value of the interest rate swap for the period from July 2, 20X0, to December 31, 20X0, is a loss of \$3,803,843.

815-25-55-102 In both Cases A and B in this Example, Entity XYZ presents the total change in the fair value of the hedging instrument (that is, the interest accruals and all other changes in fair value) in the same income statement line item (in this case, interest expense) that is used by Entity XYZ to present the earnings effect of the hedged item before applying hedge accounting in accordance with paragraph 815-20-45-1A.

> > > Case A: Using the Full Contractual Coupon Cash Flows

815-25-55-103 In this Case, assume that Entity XYZ elected to calculate fair value changes in the hedged item attributable to interest rate risk using the full contractual coupon cash flows of the hedged item. The change in fair value of the debt attributable to changes in the benchmark interest rate for the period July 2, 20X0, to December 31, 20X0, is a gain of \$3,634,395, calculated as follows.

<i>July 2, 20X0—beginning balance</i>		
\$4,000,000pmt, 4.0%i, 10n, 100,000,000fv, PV =		\$ 100,000,000
<i>December 31, 20X0—ending balance</i>		
\$4,000,000pmt, 4.5%i, 9n, 100,000,000fv, PV =		96,365,605
Change in value		<u>\$ 3,634,395</u>

815-25-55-104 As of December 31, 20X0, the fair value of the debt attributable to interest rate risk is calculated by discounting the full contractual coupon cash flows at the debt's original market rate with a 100 basis point adjustment related to the increase in the LIBOR swap rate (50 basis point adjustment on a semiannual basis). The following journal entries illustrate the interest rate swap and debt fair value changes attributable to changes in the LIBOR swap rate.

Debt	\$	3,634,395		
Interest expense			\$	3,634,395
Interest expense		3,803,843		
Swap liability				3,803,843

815-25-55-105 The net earnings effect of the hedge is \$169,448 due to the mismatch between the changes in fair value of the hedging instrument and the hedged item attributable to the changes in the benchmark interest rate.

> > > Case B: Using the Benchmark Rate Component of the Contractual Coupon Cash Flows

815-25-55-106 In this Case, assume that Entity XYZ elected to calculate fair value changes in the hedged item attributable to interest rate risk using the benchmark rate component of the contractual coupon cash flows of the hedged item determined at hedge inception. The change in fair value of the debt attributable to changes in the benchmark interest rate for the period July 2, 20X0, to December 31, 20X0, is a gain of \$3,803,843, calculated as follows.

<i>July 2, 20X0—beginning balance</i>	
\$3,000,000pmt, 3.0%i, 10n, 100,000,000fv, PV =	\$ 100,000,000
<i>December 31, 20X0—ending balance</i>	
\$3,000,000pmt, 3.5%i, 9n, 100,000,000fv, PV =	96,196,157
Change in value	<u>\$ 3,803,843</u>

815-25-55-107 As of December 31, 20X0, the fair value of the debt attributable to interest rate risk is calculated by discounting the benchmark rate component of the contractual coupon cash flows using the benchmark interest rate at December 31, 20X0 (7 percent annual rate; 3.5 percent for each semiannual period). The following journal entries illustrate the interest rate swap and debt fair value changes attributable to changes in the LIBOR swap rate.

Debt	\$	3,803,843		
Interest expense			\$	3,803,843
Interest expense		3,803,843		
Swap liability				3,803,843

815-25-55-108 The net earnings effect of the hedge is zero due to the perfect offset in fair value changes between the hedging instrument and the hedged item attributable to the changes in the benchmark interest rate.

Amendments to Subtopic 815-30

19. Amend paragraph 815-30-05-1, with a link to transition paragraph 815-20 65-3, as follows:

Derivatives and Hedging—Cash Flow Hedges

Overview and Background

815-30-05-1 This Subtopic provides incremental guidance on accounting for and financial reporting of **cash flow hedges** established under the criteria in Subtopic 815-20 such as subsequent measurement and dedesignation of a hedging relationship. Implementation guidance and examples specific to cash flow hedges are included in both Subtopic 815-20 and this Subtopic.

Scope and Scope Exceptions

> Overall Guidance

815-30-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in Subtopic 815-20, see Section 815-20-15, with specific exceptions noted below.

> Entities

815-30-15-2 The guidance in this Subtopic does not apply to the following entities:

- a. Entities that do not report earnings. Those entities are not permitted to use **cash flow hedge** accounting because they do not report earnings separately.

815-30-15-3 Consistent with the provisions of Topic 958, this Subtopic does not prescribe how a not-for-profit entity (NFP) should determine the components of an operating measure, if one is presented. For guidance on the application of this Subtopic by not-for-profit health care entities, see Subtopic 954-815.

Recognition

815-30-25-1 See Section 815-20-25 for the criteria under which an entity may designate a **derivative instrument** as hedging the exposure to variability in expected future cash flows that is attributable to a particular risk.

20. Amend paragraphs 815-30-35-1, 815-30-35-3, 815-30-35-5, 815-30-35-7 through 35-14 and the related heading, 815-30-35-16, 815-30-35-19, 815-30-35-22 through 35-23, 815-30-35-25 through 35-27, 815-30-35-29, 815-30-35-31, 815-30-35-33 through 35-34, 815-30-35-38 through 35-39 and 815-30-35-41, supersede paragraphs 815-30-35-2, 815-30-35-4, 815-30-35-21, 815-30-35-28, 815-30-35-30, and 815-30-35-35 through 35-37, and add paragraphs 815-30-35-15A, 815-30-35-37A and its related heading, and 815-30-35-41A through 35-41C and their related heading, with a link to transition paragraph 815-20-65-3, as follows:

Subsequent Measurement

815-30-35-1 The guidance in this Section is organized as follows:

- a. Subsequent recognition and measurement of gains and losses on hedging instrument
- b. Reclassifications from accumulated other comprehensive income into earnings
- c. Hedging relationship's timing that involves uncertainty within a range
- d. Subparagraph superseded by Accounting Standards Update No. 2017-12. Alterations or terminations of offsetting third party derivative instruments.

> Subsequent Recognition and Measurement of Gains and Losses on Hedging Instrument

815-30-35-2 Paragraph superseded by Accounting Standards Update No. 2017-12. In all instances, the actual measurement of cash flow hedge ineffectiveness to be recognized in earnings each reporting period is based on the extent to which exact offset is not achieved as specified in the following paragraph. That requirement applies even if a regression or other statistical analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness supports an expectation that the hedging relationship will be highly effective and demonstrates that it has been highly effective, respectively.

815-30-35-3 The effective portion of the gain or loss on a derivative instrument designated as a cash flow hedge is reported in other comprehensive income, and the ineffective portion is reported in earnings. When the relationship between the hedged item and hedging instrument is highly effective at achieving offsetting changes in cash flows attributable to the hedged risk, an entity shall record in other comprehensive income the entire change in the fair value of the designated hedging instrument that is included in the assessment of hedge effectiveness. More specifically, a qualifying {add glossary link}cash flow hedge{add glossary link} shall be accounted for as follows:

- a. ~~If an~~ An entity's defined risk management strategy for a particular hedging relationship may exclude ~~excludes~~ a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness (as discussed in paragraphs 815-20-25-81 through ~~25-83~~; 25-83B). ~~That~~ that excluded component of the gain or loss shall be recognized ~~currently~~ in earnings either through an amortization approach in accordance with paragraph 815-20-25-83A or through a mark-to-market approach in accordance with paragraph 815-20-25-83B. Under either approach, the amount recognized in earnings for an excluded component shall be presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A. For example, if the effectiveness of a hedging relationship with an option is assessed based on changes in the option's **intrinsic value**, the changes in the option's **time value** would be excluded from the assessment of hedge effectiveness and either may be recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A or currently in earnings in accordance with paragraph 815-20-25-83B.
- b. Amounts in accumulated other comprehensive income related to the derivative designated as a hedging instrument included in the assessment of hedge effectiveness are reclassified to earnings in the same period or periods during which the hedged forecasted transaction affects earnings in accordance with paragraphs 815-30-35-38 through 35-41 and presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A. The balance in accumulated ~~Accumulated~~ other comprehensive income associated with the hedged **transaction** shall be the cumulative gain or loss on the derivative instrument from inception of the hedge less all of the following adjusted to a balance that reflects the lesser of the following (in absolute amounts):
 1. Subparagraph superseded by Accounting Standards Update No. 2017-12. ~~The cumulative gain or loss on the derivative instrument from inception of the hedge less both of the following:~~
 - i. ~~The excluded component discussed in (a)~~
 - ii. ~~The derivative instrument's gains or losses previously reclassified from accumulated other comprehensive income into earnings pursuant to paragraphs 815-30-35-38 through 35-41.~~

[Content moved to 1a below]
 - 1a. The derivative instrument's gains or losses previously reclassified from accumulated other comprehensive income into earnings pursuant to paragraphs 815-30-35-38 through 35-41. **[Content moved from ii above]**
 - 1b. The cumulative amount amortized to earnings related to excluded components accounted for through an amortization approach in accordance with paragraph 815-20-25-83A.

1c. The cumulative change in fair value of an excluded component for which changes in fair value are recorded currently in earnings in accordance with paragraph 815-20-25-83B.

2. Subparagraph superseded by Accounting Standards Update No. 2017-12. ~~The portion of the cumulative gain or loss on the derivative instrument necessary to offset the cumulative change in expected future cash flows on the hedged transaction from inception of the hedge less the derivative instrument's gains or losses previously reclassified from accumulated other comprehensive income into earnings pursuant to paragraphs 815-30-35-38 through 35-41.~~

~~That adjustment of accumulated other comprehensive income shall incorporate recognition in other comprehensive income of part or all of the gain or loss on the hedging derivative, as necessary. If hedge accounting has not been applied to a cash flow hedging relationship in a previous effectiveness assessment period because the entity's retrospective evaluation indicated that the relationship had not been highly effective in achieving offsetting changes in cash flows in that period, the cumulative gain or loss on the derivative referenced in (b) would exclude the gains or losses occurring during that period. Similarly, the cumulative change in expected future cash flows on the hedged transaction would exclude the changes related to that period when hedge accounting has not been applied. That situation may arise if the entity had previously determined, for example, under a regression analysis or other appropriate statistical analysis approach used for prospective assessments of hedge effectiveness, that there was an expectation in which the hedging relationship would be highly effective in future periods. Consequently, the hedging relationship continued even though hedge accounting was not permitted for a specific previous effectiveness assessment period.~~

c. Subparagraph superseded by Accounting Standards Update No. 2017-12. ~~A gain or loss shall be recognized in earnings, as necessary, for any remaining gain or loss on the hedging derivative or to adjust other comprehensive income to the balance specified in (b).~~

d. If a non-option-based contract is the hedging instrument in a cash flow hedge of the variability of the functional-currency-equivalent cash flows for a recognized foreign-currency-denominated asset or liability that is remeasured at spot exchange rates under paragraph 830-20-35-1, an amount that will both offset the related transaction gain or loss arising from that remeasurement and adjust earnings for that period's allocable portion of the initial spot-forward difference associated with the hedging instrument (cost to the purchaser or income to the seller of the hedging instrument) shall be reclassified each period from other comprehensive income to earnings if the assessment of effectiveness ~~and measurement of ineffectiveness are~~ is based on total changes in the non-option-based instrument's cash flows. If an option contract is used as the hedging instrument in a cash flow hedge of the variability of the functional-

currency-equivalent cash flows for a recognized foreign-currency-denominated asset or liability that is remeasured at spot exchange rates under paragraph 830-20-35-1 to provide only one-sided offset against the hedged **foreign exchange risk**, an amount shall be reclassified each period to or from other comprehensive income with respect to the changes in the **underlying** that result in a change in the hedging option's intrinsic value. **[Content moved from (e)]** ~~If~~ **In addition**, if the assessment of effectiveness ~~and measurement of ineffectiveness are~~ **is** based on total changes in the option's cash flows (that is, the assessment will include the hedging instrument's entire change in **fair value**—its entire gain or loss), an amount that adjusts earnings for the amortization of the cost of the option on a rational basis shall be reclassified each period from other comprehensive income to earnings. This guidance is limited to foreign currency hedging relationships because of their unique ~~attributes~~. ~~That accounting guidance attributes and~~ **is an exception for foreign currency hedging relationships**. **[Content amended as shown and moved from (f)]**

- e. ~~Subparagraph superseded by Accounting Standards Update No. 2017-12. If an option contract is used as the hedging instrument in a cash flow hedge of the variability of the functional currency equivalent cash flows for a recognized foreign-currency-denominated asset or liability that is remeasured at spot exchange rates under paragraph 830-20-35-1 to provide only one-sided offset against the hedged foreign exchange risk, an amount shall be reclassified each period to or from other comprehensive income with respect to the changes in the underlying that result in a change in the hedging option's intrinsic value. [Content moved to (d)]~~
- f. ~~Subparagraph superseded by Accounting Standards Update No. 2017-12. If the assessment of effectiveness and measurement of ineffectiveness are based on total changes in the option's cash flows (that is, the assessment will include the hedging instrument's entire change in fair value—its entire gain or loss), an amount that adjusts earnings for the amortization of the cost of the option on a rational basis shall be reclassified each period from other comprehensive income to earnings. This guidance is limited to foreign currency hedging relationships because of their unique attributes. That accounting guidance is an exception for foreign currency hedging relationships. [Content amended and moved to (d)]~~

815-30-35-4 ~~Paragraph superseded by Accounting Standards Update No. 2017-12. The adjustment of accumulated other comprehensive income required by (b) in the preceding paragraph shall incorporate recognition in other comprehensive income of part or all of the gain or loss on the hedging derivative, as necessary.~~

815-30-35-5 If an entity has designated and documented that it will assess effectiveness and measure hedge results ~~effectiveness~~ of a cash flow hedge of

foreign currency risk on an after-tax basis as permitted by paragraph 815-20-25-3(b)(2)(vi), the portion of the gain or loss on the hedging instrument that exceeded the loss or gain on the hedged item shall be included as an offset to the related tax effects in the period in which those tax effects are recognized.

815-30-35-6 Remeasurement of the hedged foreign-currency-denominated assets and liabilities is based on the guidance in Topic 830, which requires remeasurement based on spot exchange rates, regardless of whether a cash flow hedging relationship exists.

815-30-35-7 Examples 1 through 4 (see paragraphs 815-30-55-1A through 55-19) illustrate assessing hedge effectiveness ~~and measuring hedge ineffectiveness~~. ~~Examples 7 (see paragraph 815-30-55-34) and Example 10 (see paragraph 815-30-55-63) illustrate~~ illustrates the application of paragraph 815-30-35-3.

815-30-35-8 The remainder of this guidance addresses the following matters:

- a. Application to single cash flow hedge of a forecasted sale or purchase on credit for foreign exchange risk
- b. ~~Hedge ineffectiveness~~ Assessing hedge effectiveness in certain cash flow hedges involving interest rate risk when effectiveness is assessed on a quantitative basis
- c. Hedging relationship in which hedge effectiveness is based on an option's terminal value.
- d. Change in the designated hedged risk.

> > Application to Single Cash Flow Hedge of a Forecasted Sale or Purchase on Credit for Foreign Exchange Risk

815-30-35-9 For a single cash flow hedge that encompasses the variability of functional-currency-equivalent cash flows attributable to foreign exchange risk related to the settlement of a foreign-currency-denominated receivable or payable resulting from a forecasted sale or purchase on credit, the guidance in paragraph 815-30-35-3 is applied as follows:

- a. ~~The effective portion of the gain or loss on the derivative instrument that is included in the assessment of hedge effectiveness~~ is reported in other comprehensive income during the period before the forecasted purchase or sale.
- b. The functional currency interest rate implicit in the hedging relationship as a result of entering into the forward contract is used to determine the amount of cost or income to be ascribed to each period of the hedging relationship. The cash flow hedging model for recognized foreign-currency-denominated assets and liabilities requires use of the interest method at the inception of the hedging relationship to determine the amount of cost or income to be ascribed to each relevant period of the

hedging relationship. However, for simplicity, in hedging relationships in which the hedged item is a short-term non-interest-bearing account receivable or account payable, the amount of cost or income to be ascribed each period can also be determined using a pro rata method based on the number of days or months of the hedging relationship. In addition, in a short-term single cash flow hedging relationship that encompasses the variability of functional-currency-equivalent cash flows attributable to foreign exchange risk related to the settlement of a foreign-currency-denominated receivable or payable resulting from a forecasted sale or purchase on credit, the amount of cost or income to be ascribed each period can also be determined using a pro rata method or a method that uses two foreign currency forward exchange rates. The first foreign currency forward exchange rate would be based on the maturity date of the forecasted purchase or sale transaction. The second foreign currency forward exchange rate would be based on the settlement date of the resulting account receivable or account payable.

- c. For forecasted sales on credit, the amount of cost or income ascribed to each forecasted period is reclassified from other comprehensive income to earnings on the date of the sale. For forecasted purchases on credit, the amount of cost or income ascribed to each forecasted period is reclassified from other comprehensive income to earnings in the same period or periods during which the asset acquired affects earnings. The reclassification from other comprehensive income to earnings of the amount of cost or income ascribed to each forecasted period is based on the guidance in paragraphs 815-30-35-38 through 35-41.
- d. The income or cost ascribed to each period encompassed within the periods of the recognized foreign-currency-denominated receivable or payable is reclassified from other comprehensive income to earnings at the end of each reporting period.

Example 18 (see paragraph 815-30-55-106) illustrates such a transaction.

> > Assessing Hedge Effectiveness ~~Ineffectiveness~~ in Certain Cash Flow Hedges Involving Interest Rate Risk When Effectiveness Is Assessed on a Quantitative Basis

815-30-35-10 This guidance addresses the following three methods of assessing ~~ineffectiveness~~ effectiveness of certain cash flow hedges when hedge effectiveness is assessed on a quantitative basis in accordance with paragraphs 815-20-25-3(b)(2)(iv)(01) and 815-20-35-2 through 35-2F:

- a. Change-in-variable-cash-flows method
- b. Hypothetical-derivative method
- c. Change-in-fair-value method.

815-30-35-11 Those three methods relate to ~~calculating~~ assessing the ~~effectiveness~~ ineffectiveness of a cash flow hedge that involves any of the following:

- a. A receive-variable, pay-fixed interest rate swap designated as a hedge of the variable interest payments on an existing floating-rate liability
- b. A receive-fixed, pay-variable interest rate swap designated as a hedge of the variable interest receipts on an existing variable-rate asset
- c. Cash flow hedges of the variability of future interest payments on interest-bearing assets to be acquired or interest-bearing liabilities to be incurred (such as the rollover of an entity's short-term debt as described in Example 9 [see paragraph 815-30-55-52]).

815-30-35-12 ~~Depending on the interest rate index (or indexes) involved and the expected effectiveness of the hedging interest rate swap, the~~ The hedging relationships covered by this guidance encompass either of the following:

- a. Hedges of interest rate risk (pursuant to paragraph ~~815-20-25-15(i)(2))~~ ~~815-20-25-15(j)(2))~~, for example, a hedging relationship that ~~does do not~~ qualify for the shortcut method that involves an interest rate swap with its ~~variable rate index based on the~~ **London Interbank Offered Rate (LIBOR) swap rate (a benchmark interest rate)** designated as a hedge of a ~~variable rate asset or liability with an interest rate index also based on the LIBOR swap rate~~
- b. Hedges of the risk of overall changes in the hedged cash flows related to the asset or liability (pursuant to paragraph ~~815-20-25-15(i)(1))~~ ~~815-20-25-15(j)(1))~~, for example, a hedging relationship involving an interest rate swap with its ~~variable rate index based on a bank's prime rate designated as a hedge of a variable rate asset or liability with an interest rate index also based on the same prime rate. That hedging relationship may not qualify for the shortcut method because the shortcut method applies only to hedges of interest rate risk, and the designated variable rate index giving rise to variability in cash flows is not a benchmark interest rate.~~

815-30-35-13 If, at the inception of the hedge, the fair value of the interest rate swap designated as the hedging instrument is zero or is somewhat near zero, any of the three methods in paragraph 815-30-35-10 may be applied to assess hedge effectiveness.

815-30-35-14 In contrast, if, at the inception of the hedge, the fair value of the interest rate swap is not somewhat near zero, the change-in-variable-cash-flows method shall not be applied to assess hedge effectiveness because that method does not require entities to consider ~~recognize in income currently the ineffectiveness related to~~ the interest element of the change in fair value of a hedging instrument that incorporates a financing element; instead, either the hypothetical-derivative method or the change-in-fair-value method shall be applied. Those latter two methods require entities to consider ~~recognize in income~~

~~currently the ineffectiveness related to~~ the interest element of the change in fair value of a hedging instrument that incorporates a financing element that is not somewhat near zero, such as if the interest rate swap has been structured to be significantly in the money at the inception of the hedging relationship.

815-30-35-15 Under all three methods, an entity shall consider the risk of default by counterparties that are obligors with respect to the hedging instrument (the interest rate swap) or hedged transaction, pursuant to the guidance in paragraphs 815-20-25-122 and 815-20-25-16(a), respectively. An underlying assumption in this guidance is that the likelihood of the obligor not defaulting is assessed as being probable.

815-30-35-15A When assessing hedge effectiveness using any of the three methods specified in paragraph 815-30-35-10, in addition to the guidance specific to each method, an entity also shall apply the general guidance in paragraph 815-20-25-79 on prospective considerations and retrospective evaluations of hedge effectiveness.

> > > Change-in-Variable-Cash-Flows Method

815-30-35-16 ~~The~~ An entity shall assess hedge effectiveness under the change-in-variable-cash-flows method ~~measures hedge ineffectiveness based on a comparison of~~ by comparing the following items:

- a. The variable leg of the interest rate swap
- b. The hedged variable-rate cash flows on the asset or liability.

815-30-35-17 As noted in paragraph 815-30-35-14, the change-in-variable-cash-flows method shall not be used in certain circumstances.

815-30-35-18 The change-in-variable-cash-flows method is consistent with the cash flow hedge objective of effectively offsetting the changes in the hedged cash flows attributable to the hedged risk. The method is based on the premise that only the floating-rate component of the interest rate swap provides the cash flow hedge, and any change in the interest rate swap's fair value attributable to the fixed-rate leg is not relevant to the variability of the hedged interest payments (receipts) on the floating-rate liability (asset).

815-30-35-19 ~~Under this method, the interest rate swap designated as the hedging instrument would be recorded at fair value on the balance sheet. The calculation of ineffectiveness involves a comparison of~~ An entity shall assess hedge effectiveness under this method by comparing the following amounts:

- a. The present value of the cumulative change in the expected future cash flows on the variable leg of the interest rate swap

- b. The present value of the cumulative change in the expected future interest cash flows on the variable-rate asset or liability.

815-30-35-20 Because the focus of a cash flow hedge is on whether the hedging relationship achieves offsetting changes in cash flows, if the variability of the hedged cash flows of the variable-rate asset or liability is based solely on changes in a variable-rate index, the present value of the cumulative changes in expected future cash flows on both the variable-rate leg of the interest rate swap and the variable-rate asset or liability shall be calculated using the discount rates applicable to determining the fair value of the interest rate swap.

815-30-35-21 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~If hedge ineffectiveness exists, accumulated other comprehensive income shall be adjusted to a balance that reflects the difference between the overall change in fair value of the interest rate swap since the inception of the hedging relationship and the amount of ineffectiveness that shall be recorded in earnings.~~

815-30-35-22 The change-in-variable-cash-flows method will result in ~~no ineffectiveness being recognized in earnings~~ a perfectly effective hedge if all of the following conditions are met:

- a. The variable-rate leg of the interest rate swap and the hedged variable cash flows of the asset or liability are based on the same interest rate index (for example, three-month London Interbank Offered Rate (LIBOR) swap rate LIBOR).
- b. The interest rate reset dates applicable to the variable-rate leg of the interest rate swap and to the hedged variable cash flows of the asset or liability are the same.
- c. The hedging relationship does not contain any other basis differences (for example, ~~ineffectiveness could be created~~ if the variable leg of the interest rate swap contains a cap and the variable-rate asset or liability does not).
- d. The likelihood of the obligor not defaulting is assessed as being probable.

815-30-35-23 However, ~~ineffectiveness would be expected to result~~ a hedge would not be perfectly effective if any basis differences existed. For example, ~~ineffectiveness~~ this would be expected to result from either of the following conditions, among others:

- a. A difference in the indexes used to determine cash flows on the variable leg of the interest rate swap (for example, the three-month U.S. Treasury rate) and the hedged variable cash flows of the asset or liability (for example, three-month LIBOR)
- b. A mismatch between the interest rate reset dates applicable to the variable leg of the interest rate swap and the hedged variable cash flows of the hedged asset or liability.

815-30-35-24 Example 15 (see paragraph 815-30-55-91) illustrates the application of the change-in-variable-cash-flows method.

> > Hypothetical-Derivative Method

815-30-35-25 ~~An entity shall assess hedge effectiveness under the The~~ hypothetical-derivative method ~~measures hedge ineffectiveness based on a comparison of by comparing~~ the following amounts:

- a. The change in fair value of the actual interest rate swap designated as the hedging instrument
- b. The change in fair value of a hypothetical interest rate swap having terms that identically match the critical terms of the floating-rate asset or liability, including all of the following:
 1. The same **notional amount**
 2. The same repricing dates
 3. The same index (that is, the index on which the hypothetical interest rate swap's variable rate is based matches the index on which the asset or liability's variable rate is based)
 4. Mirror image caps and floors
 5. A zero fair value at the inception of the hedging relationship.

815-30-35-26 Essentially, the hypothetical derivative would need to satisfy all of the applicable conditions in paragraphs 815-20-25-104 and 815-20-25-106 necessary to qualify for use of the shortcut method except the criterion in paragraph 815-20-25-106(g) ~~815-20-25-104(f)~~ and the criterion in paragraph 815-20-25-104(e). Thus, the hypothetical interest rate swap would be expected to perfectly offset the hedged cash flows. Because the requirements of paragraph 815-20-25-104(e) were developed with an emphasis on fair value hedging relationships, they do not fit the more general principle that the hypothetical derivative in a cash flow hedging relationship should be expected to perfectly offset the hedged cash flows.

815-30-35-27 The change in the fair value of the perfect hypothetical interest rate swap can be regarded as a proxy for the present value of the cumulative change in expected future cash flows on the hedged transaction ~~as described in paragraph 815-30-35-3(b)(2).~~

815-30-35-28 ~~Paragraph superseded by Accounting Standards Update No. 2017-12. Under the hypothetical-derivative method, the entity shall do both of the following:~~

- ~~a. The actual interest rate swap shall be recorded at fair value on the balance sheet.~~
- ~~b. Accumulated other comprehensive income shall be adjusted to a balance that reflects the lesser of the following amounts:~~

1. ~~The cumulative change in the fair value of the actual interest rate swap~~
2. ~~The cumulative change in the fair value of a perfect hypothetical interest rate swap.~~

815-30-35-29 The determination of the fair value of both the perfect hypothetical interest rate swap and the actual interest rate swap shall use discount rates based on the relevant interest rate swap curves. ~~The amount of ineffectiveness, if any, recorded in earnings would be equal to the excess of the cumulative change in the fair value of the actual interest rate swap over the cumulative change in the fair value of the perfect hypothetical interest rate swap.~~

815-30-35-30 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~Paragraph 815-30-35-3(b) indicates that hedge ineffectiveness in a cash flow hedge occurs only if the cumulative gain or loss on the derivative hedging instrument exceeds the cumulative change in the expected future cash flows on the hedged transaction.~~

> > > Change-in-Fair-Value Method

815-30-35-31 An entity shall assess hedge effectiveness under the ~~The change-in-fair-value method measures hedge ineffectiveness based on a calculation that compares by comparing~~ the following amounts:

- a. The present value of the cumulative change in expected variable future interest cash flows that are designated as the hedged transactions
- b. The cumulative change in the fair value of the interest rate swap designated as the hedging instrument.

815-30-35-32 The discount rates applicable to determining the fair value of the interest rate swap designated as the hedging instrument shall also be applied to the computation of present values of the cumulative changes in the hedged cash flows.

> > Hedging Relationship in Which Hedge Effectiveness Is Based on an Option's Terminal Value

815-30-35-33 If an entity concludes under ~~paragraph~~ paragraphs 815-20-25-129 through 25-129A that the hedging relationship may not be considered to be perfectly effective, ~~the entity shall simply record all changes in the hedging option's fair value (including changes in the option's time value) in other comprehensive income. If the four conditions in that paragraph are not met, the entity shall assess hedge effectiveness determine whether ineffectiveness must be recognized in earnings by comparing the following amounts:~~

- a. The change in fair value of the actual hedging instrument

- b. The change in fair value of a perfectly effective hypothetical hedging instrument. That hypothetical hedging instrument shall have terms that meet the four conditions listed in ~~paragraph~~ paragraphs 815-20-25-129 through 25-129A.

815-30-35-34 The change in fair value of the hypothetical hedging instrument can be regarded as a proxy for the present value of the cumulative change in expected future cash flows on the hedged transaction(s) ~~as described in paragraph 815-30-35-3(b)(2)~~.

815-30-35-35 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~If ineffectiveness is required to be recognized, accumulated other comprehensive income would be adjusted to a balance that reflects the lesser of either the cumulative change in the fair value of the actual hedging instrument or the cumulative change in the fair value of the hypothetical hedging instrument. (Consistent with paragraph 815-30-35-3(b)[1], that comparison excludes the effect of the hedging instrument's gains or losses previously reclassified from accumulated other comprehensive income into earnings pursuant to paragraphs 815-30-35-38 through 35-41.) The amount of ineffectiveness, if any, recorded in earnings would be equal to the excess of the cumulative change in the fair value of the actual hedging instrument over the cumulative change in the fair value of the hypothetical hedging instrument. Paragraph 815-30-35-3(b) indicates that hedge ineffectiveness in a cash flow hedge occurs only if the cumulative gain or loss on the hedging instrument exceeds the cumulative change in the expected future cash flows on the hedged transactions.~~

815-30-35-36 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~The portion of the gain or loss that is reported in accumulated other comprehensive income would be reclassified out of other comprehensive income consistent with the provisions in paragraphs 815-30-35-38 through 35-41. For example, the fair value of a single cap at the inception of a hedging relationship of interest rate risk on variable rate debt with quarterly interest payments over the next two years for which the entity determines that the relationship will not result in any ineffectiveness should be allocated to the respective caplets within the single cap on a fair value basis at the inception of the hedging relationship. The change in each respective allocated fair value amount should be reclassified out of accumulated other comprehensive income into earnings when each of the hedged **forecasted transactions** (the eight interest payments) affects earnings. Because the amount in accumulated other comprehensive income is a net amount composed of both derivative instrument gains and derivative instrument losses, the change in the respective allocated fair value amount for an individual caplet that is reclassified out of accumulated other comprehensive income into earnings may possibly be greater than the net amount in accumulated other comprehensive income. [Content amended and moved to paragraph 815-30-35-41B]~~

815-30-35-37 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~This guidance has no effect on the accounting for fair value hedging relationships. In addition, in determining the accounting for seemingly similar cash flow hedging relationships, it would be inappropriate to analogize to this guidance.~~ [Content moved to paragraph 815-30-35-41C]

> > Change in Designated Hedged Risk

815-30-35-37A If the designated hedged risk changes during the life of a hedging relationship, an entity may continue to apply hedge accounting if the hedging instrument is highly effective at achieving offsetting cash flows attributable to the revised hedged risk. The guidance in paragraph 815-20-55-56 does not apply to changes in the hedged risk for a cash flow hedge of a forecasted transaction.

> Reclassifications from Accumulated Other Comprehensive Income into Earnings

815-30-35-38 Amounts in accumulated other comprehensive income that are included in the assessment of effectiveness shall be reclassified into earnings in the same period or periods during which the hedged forecasted transaction affects earnings (for example, when a forecasted sale actually ~~occurs~~; occurs) and shall be presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A. If an entity excludes a component of a hedging instrument from the assessment of effectiveness, an entity shall apply the guidance in paragraphs 815-20-25-83A through 25-83B.

815-30-35-39 If the hedged transaction results in the acquisition of an asset or the incurrence of a liability, the gains and losses in accumulated other comprehensive income that are included in the assessment of effectiveness shall be reclassified into earnings in the same period or periods during which the asset acquired or liability incurred affects earnings (such as in the periods that depreciation expense, interest expense, or cost of sales is recognized).

815-30-35-40 However, if an entity expects at any time that continued reporting of a loss in accumulated other comprehensive income would lead to recognizing a net loss on the combination of the hedging instrument and the hedged transaction (and related asset acquired or liability incurred) in one or more future periods, a loss shall be reclassified immediately into earnings for the amount that is not expected to be recovered.

815-30-35-41 For example, a loss shall be reported in earnings for a derivative instrument that is designated as hedging the forecasted purchase of inventory to the extent that the cost basis of the inventory plus the related amount reported in accumulated other comprehensive income exceeds the amount expected to be recovered through sales of that inventory. (Impairment guidance is provided in

~~paragraphs 815-30-35-42 through 35-43 the following paragraph and paragraph 815-30-35-43.)~~

> > Non-Zero Fair Value of Hedging Derivative at Hedge Inception

815-30-35-41A An entity may designate a hedging derivative with periodic cash settlements and a non-zero fair value at hedge inception as the hedging instrument in a qualifying cash flow hedging relationship. In this situation, amounts related to the initial fair value that are recorded in other comprehensive income during the hedging relationship shall be reclassified from accumulated other comprehensive income to earnings on a systematic and rational basis over the periods during which the hedged forecasted transactions affect earnings. Amounts reclassified to earnings shall be presented in the same income statement line item as the earnings effect of the hedged item. This guidance applies to both option-based and non-option-based derivatives designated as hedging instruments in a cash flow hedge.

815-30-35-41B ~~The portion of the gain or loss that is reported in accumulated other comprehensive income would be reclassified out of other comprehensive income consistent with the provisions in paragraphs 815-30-35-38 through 35-41. This paragraph illustrates a method of reclassifying amounts from accumulated other comprehensive income to earnings when an option-based derivative is designated as a hedging instrument and the assessment of effectiveness is based on total changes in the derivative's cash flows. Those amounts include changes in fair value related to the derivative's initial intrinsic value in accordance with paragraph 815-30-35-41A. For example, the fair value of a single cap at the inception of a hedging relationship of interest rate risk on variable-rate debt with quarterly interest payments over the next two years for which the entity determines that the relationship will not result in any ineffectiveness should be allocated to the respective caplets within the single cap on a fair value basis at the inception of the hedging relationship. The change in each respective allocated fair value amount should be reclassified out of accumulated other comprehensive income into earnings when each of the hedged forecasted transactions (the eight interest payments) affects earnings. Because the amount in accumulated other comprehensive income is a net amount composed of both derivative instrument gains and derivative instrument losses, the change in the respective allocated fair value amount for an individual caplet that is reclassified out of accumulated other comprehensive income into earnings may possibly be greater than the net amount in accumulated other comprehensive income. [Content amended as shown and moved from paragraph 815-30-35-36]~~

815-30-35-41C This guidance has no effect on the accounting for fair value hedging relationships. In addition, in determining the accounting for seemingly similar cash flow hedging relationships, it would be inappropriate to analogize to this guidance. [Content moved from paragraph 815-30-35-37]

> > Interaction with Impairment Principles

815-30-35-42 Existing requirements in generally accepted accounting principles (GAAP) for assessing asset impairment or recognizing an increased obligation apply to an asset or liability that gives rise to variable cash flows (such as a variable-rate **financial instrument**) for which the variable cash flows (the forecasted transactions) have been designated as being hedged and accounted for pursuant to paragraphs 815-30-35-3 and 815-30-35-38 through 35-41. Those impairment requirements shall be applied each period after hedge accounting has been applied for the period, pursuant to those paragraphs. The fair value or expected cash flows of a hedging instrument shall not be considered in applying those requirements. The gain or loss on the hedging instrument in accumulated other comprehensive income shall, however, be accounted for as discussed in paragraphs 815-30-35-38 through 35-41.

Pending Content:

Transition Date: (P) December 16, 2019; (N) December 16, 2020 | **Transition Guidance:** 326-10-65-1

Editor's Note: The content of paragraph 815-30-35-42 will be amended upon transition, together with a change in the heading noted below.

> > Interaction with Impairment and Credit Loss Principles

815-30-35-42 Existing requirements in generally accepted accounting principles (GAAP) for assessing asset impairment or credit losses or recognizing an increased obligation apply to an asset or liability that gives rise to variable cash flows (such as a variable-rate **financial instrument**) for which the variable cash flows (the forecasted transactions) have been designated as being hedged and accounted for pursuant to paragraphs 815-30-35-3 and 815-30-35-38 through 35-41. Those impairment or credit loss requirements shall be applied each period after hedge accounting has been applied for the period, pursuant to those paragraphs. The fair value or expected cash flows of a hedging instrument shall not be considered in applying those requirements. The gain or loss on the hedging instrument in accumulated other comprehensive income shall, however, be accounted for as discussed in paragraphs 815-30-35-38 through 35-41.

815-30-35-43 If, under existing requirements in GAAP, an impairment loss is recognized on an asset or an additional obligation is recognized on a liability to which a hedged forecasted transaction relates, any offsetting net gain related to that transaction in accumulated other comprehensive income shall be reclassified immediately into earnings. Similarly, if a recovery is recognized on the asset or liability to which the forecasted transaction relates, any offsetting net loss that has

been accumulated in other comprehensive income shall be reclassified immediately into earnings.

Pending Content:

Transition Date: *(P) December 16, 2019; (N) December 16, 2020* | **Transition Guidance:** 326-10-65-1

815-30-35-43 If, under existing requirements in GAAP, an asset impairment loss or writeoff due to credit losses is recognized on an asset or an additional obligation is recognized on a liability to which a hedged forecasted transaction relates, any offsetting or corresponding net gain related to that transaction in accumulated other comprehensive income shall be reclassified immediately into earnings. Similarly, if a recovery is recognized on the asset or liability to which the forecasted transaction relates, any offsetting net loss that has been accumulated in other comprehensive income shall be reclassified immediately into earnings.

> > Gains or Losses from Cash Flow Hedges of Debt That Is Extinguished

815-30-35-44 If the reclassification to earnings of the amount in accumulated comprehensive income resulting from a cash flow hedge of debt is required under this Subsection when that debt is extinguished, the amount reclassified from accumulated comprehensive income to earnings shall be excluded from extinguishment gain or loss.

> > Forecasted Interest Payment Capitalized as a Cost of an Asset under Construction

815-30-35-45 If the variable-rate interest on a specific borrowing is associated with an asset under construction and capitalized as a cost of that asset, the amounts in accumulated other comprehensive income related to a cash flow hedge of the variability of that interest shall be reclassified into earnings over the depreciable life of the constructed asset, because that depreciable life coincides with the amortization period for the capitalized interest cost on the debt.

> Hedging Relationship's Timing Involves Uncertainty within a Range

815-30-35-46 For forecasted transactions whose timing involves some uncertainty within a range, paragraph 815-20-25-16(c) states that, as long as it remains probable that the forecasted transaction will occur by the end of the originally specified time period, cash flow hedge accounting for that hedging relationship shall continue.

815-30-35-47 Paragraph not used.

21. Amend paragraphs 815-30-40-2 and 815-30-40-5 and add paragraph 815-30-40-6A and its related heading, with a link to transition paragraph 815-20-65-3, as follows:

Derecognition

> Discontinuing Hedge Accounting

815-30-40-1 An entity shall discontinue prospectively the accounting specified in paragraphs 815-30-35-3 and 815-30-35-38 through 35-41 for an existing hedge if any one of the following occurs:

- a. Any criterion in Section 815-30-25 is no longer met.
- b. The **derivative instrument** expires or is sold, terminated, or exercised.
- c. The entity removes the designation of the **cash flow hedge**.

815-30-40-1A For the purposes of applying the guidance in paragraph 815-30-40-1, a change in the counterparty to a derivative instrument that has been designated as the hedging instrument in an existing hedging relationship would not, in and of itself, be considered a termination of the derivative instrument.

815-30-40-2 In ~~these~~ the circumstances discussed in paragraph 815-30-40-1, the net gain or loss shall remain in accumulated other comprehensive income and be reclassified into earnings as specified in paragraphs 815-30-35-38 through 35-41. Example 16 (see paragraph 815-30-55-94) illustrates the application of paragraph 815-30-35-3 if a hedging relationship is terminated.

815-30-40-3 Furthermore, the entity may elect to designate prospectively a new hedging relationship with a different hedging instrument or, in the circumstances described in paragraph 815-30-40-1(a) and 815-30-40-1(c), a different hedged **transaction** or a hedged item if the hedging relationship meets the applicable criteria for a cash flow hedge or a **fair value hedge**.

815-30-40-4 The net derivative instrument gain or loss related to a discontinued cash flow hedge shall continue to be reported in accumulated other comprehensive income unless it is probable that the **forecasted transaction** will not occur by the end of the originally specified time period (as documented at the inception of the hedging relationship) or within an additional two-month period of time thereafter, except as indicated in the following sentence. In rare cases, the existence of extenuating circumstances that are related to the nature of the forecasted transaction and are outside the control or influence of the reporting entity may cause the forecasted transaction to be probable of occurring on a date that is beyond the additional two-month period of time, in which case the net derivative instrument gain or loss related to the discontinued cash flow hedge shall continue

to be reported in accumulated other comprehensive income until it is reclassified into earnings pursuant to paragraphs 815-30-35-38 through 35-41.

815-30-40-5 If it is probable that the hedged forecasted transaction will not occur either by the end of the originally specified time period or within the additional two-month period of time and the hedged forecasted transaction also does not qualify for the exception described in the preceding paragraph, that derivative instrument gain or loss reported in accumulated other comprehensive income shall be reclassified into earnings immediately. A pattern of determining that hedged forecasted transactions are probable of not occurring ~~probably will not occur~~ 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.

815-30-40-6 Derivative instrument gains and losses that had initially been reported in other comprehensive income as a result of a cash flow hedge and then reclassified to earnings (because the entity subsequently concluded that it was probable that the forecasted transaction would not occur within the originally specified time period or the additional period of time described in paragraph 815-30-40-4) shall not later be reclassified out of earnings and back into accumulated other comprehensive income due to a reassessment of probabilities.

> > Amounts Excluded from the Assessment of Effectiveness under an Amortization Approach

815-30-40-6A When applying the guidance in paragraph 815-20-25-83A, if the hedged forecasted transaction is probable of not occurring, any amounts remaining in accumulated other comprehensive income related to amounts excluded from the assessment of effectiveness shall be recorded in earnings in the current period. For all other discontinued cash flow hedges, any amounts associated with the excluded component remaining in accumulated other comprehensive income shall be recorded in earnings when the hedged forecasted transaction affects earnings.

> Alterations or Terminations of Offsetting Third-Party Derivative Instruments

815-30-40-7 Paragraph 815-20-25-62 provides guidance on **internal derivatives** as hedging instruments in cash flow hedges of foreign exchange risk. Paragraph 815-20-25-63 states that, if an issuing affiliate alters or terminates any offsetting third-party derivative instrument (which should be rare), the hedging affiliate prospectively shall cease hedge accounting for the internal derivatives that are offset by that third-party derivative instrument.

22. Supersede paragraphs 815-30-45-1 through 45-3 and their related heading, with a link to transition paragraph 815-20-65-3, as follows:

Other Presentation Matters

> Other Comprehensive Income

815-30-45-1 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~An entity shall display as a separate classification within other comprehensive income the net gain or loss on derivative instruments designated and qualifying as cash flow hedging instruments that are reported in comprehensive income pursuant to paragraphs 815-20-25-65 and 815-30-35-3. [Content amended and moved to paragraph 815-20-45-3]~~

815-30-45-2 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~To measure the amount of other comprehensive income to be reclassified into earnings in the coming 12 months if multiple cash flow exposures are designated as the hedged items for a single derivative instrument, the total amount reported in other comprehensive income (as determined in accordance with paragraph 815-30-35-3(b)) for the hedging relationship first shall be allocated to each of the forecasted transactions (hedged items) within the hedging relationship. [Content moved to paragraph 815-30-50-5]~~

815-30-45-3 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~The allocation method used shall be applied consistently and shall consider any cumulative gain or loss on the derivative instrument that has been recognized in earnings as hedge ineffectiveness. After the amount reported in other comprehensive income has been allocated to each of the forecasted transactions within the hedging relationship, the entity shall sum those estimated amounts to be reclassified into earnings in the coming 12 months. [Content amended and moved to paragraph 815-30-50-6]~~

23. Amend paragraphs 815-30-50-1 through 50-2 and 815-30-50-4 and add paragraphs 815-30-50-5 through 50-6, with a link to transition paragraph 815-20-65-3, as follows:

Disclosure

815-30-50-1 See Section 815-10-50 for overall guidance on disclosures. An entity's disclosures for every annual and interim reporting period for which a statement of financial position and a statement of financial performance is presented shall include all of the following for **derivative instruments** that have been designated and have qualified as cash flow hedging instruments and for the related hedged **transactions**:

- a. Subparagraph not used
- b. A description of the transactions or other events that will result in the reclassification into earnings of gains and losses that are reported in accumulated other comprehensive income
- c. The estimated net amount of the existing gains or losses that are reported in accumulated other comprehensive income at the reporting date that is expected to be reclassified into earnings within the next 12 months
- d. The maximum length of time over which the entity is hedging its exposure to the variability in future cash flows for **forecasted transactions** excluding those forecasted transactions related to the payment of variable interest on existing **financial instruments**
- e. Subparagraph superseded by Accounting Standards Update No. 2017-12. The amount of gains and losses reclassified into earnings as a result of the discontinuance of cash flow hedges because it is probable that the original forecasted transactions will not occur by the end of the originally specified time period or within the additional period of time discussed in paragraphs 815-30-40-4 through 40-5. [Content amended and moved to paragraph 815-10-50-4C(f)]

815-30-50-2 As part of the disclosures of accumulated other comprehensive income, pursuant to paragraphs 220-10-45-14 through 45-14A, an entity shall separately disclose all of the following:

- a. The beginning and ending accumulated derivative instrument gain or loss
- b. The related net change associated with current period hedging transactions
- c. The net amount of any reclassification into earnings.
- d. The difference between the change in fair value of an excluded component and the initial value of that excluded component recognized in earnings under a systematic and rational method in accordance with paragraph 815-20-25-83A.

815-30-50-3 For guidance on qualitative disclosures, see paragraph 815-10-50-5.

> Disclosed Amount to Be Reclassified into Earnings

815-30-50-4 The amount required to be disclosed under paragraph 815-30-50-1(c) (the estimated net amount of the existing gains or losses that are reported in accumulated other comprehensive income at the reporting date that is expected to be reclassified into earnings within the next 12 months) could be greater than or less than the net amount reported in accumulated other comprehensive income. See paragraphs 815-30-45-2 through 45-3 for related guidance.

815-30-50-5 ~~Paragraph not used.~~ To measure the amount of other comprehensive income to be reclassified into earnings in the coming 12 months if multiple cash flow exposures are designated as the hedged items for a single derivative instrument, the total amount reported in other comprehensive income (as determined in accordance with paragraph 815-30-35-3(b)) for the hedging relationship first shall be allocated to each of the forecasted transactions (hedged items) within the hedging relationship. **[Content moved from paragraph 815-30-45-2]**

815-30-50-6 ~~Paragraph not used.~~ The allocation method used shall be applied consistently ~~and shall consider any cumulative gain or loss on the derivative instrument that has been recognized in earnings as hedge ineffectiveness.~~ After the amount reported in other comprehensive income has been allocated to each of the forecasted transactions within the hedging relationship, the entity shall sum those estimated amounts to be reclassified into earnings in the coming 12 months. **[Content amended as shown and moved from paragraph 815-30-45-3]**

24. Amend paragraphs 815-30-55-1 through 55-4 and the related heading, 815-30-55-8 through 55-11, 815-30-55-13 through 55-16, 815-30-55-20 through 55-22 and their related heading, 815-30-55-24 through 55-25, 815-30-55-28 through 55-29, 815-30-55-32, 815-30-55-41 through 55-43, 815-30-55-49, 815-30-55-54 through 55-57, 815-30-55-60 through 55-61, 815-30-55-63 through 55-64, 815-30-55-66, 815-30-55-70, 815-30-55-72, 815-30-55-75, 815-30-55-81 through 55-83, 815-30-55-89, 815-30-55-91 and its related heading, 815-30-55-95, 815-30-55-97 through 55-99, 815-30-55-101, 815-30-55-107, 815-30-55-109, 815-30-55-117, 815-30-55-124, 815-30-55-126 through 55-127, 815-30-55-129, and 815-30-55-132, supersede paragraphs 815-30-55-34 through 55-39 and their related heading, 815-30-55-62, 815-30-55-65, and 815-30-55-93, and add paragraphs 815-30-55-93A, 815-30-55-98A, and 815-30-55-134 through 55-148 and their related headings, with a link to transition paragraph 815-20-65-3, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Reclassification from Other Comprehensive Income to Earnings in the Next 12 Months ~~Relationship of Swap to Hedged Forecasted Transactions~~

815-30-55-1 Paragraph 815-30-50-5 ~~815-30-45-2~~ provides guidance on measuring the amount of other comprehensive income to be reclassified into earnings in the coming 12 months if multiple cash flow exposures are designated as the hedged items for a single derivative instrument. If interest rate or commodity swaps are used for cash flow hedges, in effect a single derivative is being used to hedge multiple hedged {add glossary link}forecasted transactions{add glossary

link} because a swap involves multiple cash flows (like a series of forward contracts). For instance, a five-year interest rate swap may be designated as the hedging instrument to hedge the variability in cash flows for each of the resets in a five-year variable-rate borrowing. The fair value of a swap may be the net of both positive discounted cash flows (that is, the right to receive future payments) and negative discounted cash flows (that is, the obligation to make future payments). This could happen, for example, if nearby forward rates were below the fixed rate on the swap and far-term forward rates were above the fixed rate on the swap, in which case an entity could have an expectation of having to make cash outflows on the swap for nearby exposures and to receive cash inflows on the swap for the far-term exposures.

> Illustrations

> > Example 1: Effectiveness of Cash Flow Hedge of a Forecasted Purchase of Inventory with a Forward Contract

815-30-55-1A This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to assessing effectiveness ~~and measuring ineffectiveness~~ for a **cash flow hedge** of a forecasted purchase of inventory with a forward contract in which the forward contract index differs from the index of the underlying hedged transaction. Assume that the entity elected to perform subsequent quarterly hedge effectiveness assessments on a quantitative basis and that all hedge documentation requirements were satisfied ~~hedge satisfied all of the criteria for hedge accounting~~ at inception.

815-30-55-2 Entity G forecasts the purchase of 500,000 pounds of Brazilian coffee for U.S. dollars in 6 months. The agreement outlining purchase terms between Entity G and its supplier contains a **contractually specified component** referencing a Brazilian coffee index denominated in U.S. dollars. Entity G designates the variability in cash flows related to its forecasted purchase of Brazilian coffee attributable to changes in the contractually specified component (Brazilian coffee index) as the hedged risk. It wants to hedge the cash flow exposure associated with changes in the U.S. dollar price of Brazilian coffee. Rather than acquire a **derivative instrument** based on Brazilian coffee, Entity G enters into a 6-month forward contract to purchase 500,000 pounds of Colombian coffee for U.S. dollars and designates the forward contract as a hedging instrument in a cash flow hedge of its forecasted purchase of the variability in cash flows attributable to changes in the contractually specified Brazilian coffee index component of its forecasted purchase of Brazilian coffee. All other terms of the forward contract and the forecasted purchase, such as delivery locations, are the same.

815-30-55-3 Entity G bases its assessment of hedge effectiveness ~~and measure of ineffectiveness~~ on changes in forward prices, with the resulting gain or loss discounted to reflect the time value of money. ~~Because of the difference in the bases of the forecasted transaction (Brazilian coffee) and forward contract (Colombian coffee), Entity G may not assume that the hedge will automatically be highly effective in achieving offsetting cash flows.~~ Both at inception and on an ongoing basis, Entity G could assess the effectiveness of the hedge by comparing changes in the expected cash flows from the Colombian coffee forward contract with the expected net change in cash outflows attributable to changes in the contractually specified component for purchasing the Brazilian coffee for different market prices. (A simpler method that should produce the same results would consider the expected future correlation of the prices of Brazilian and Colombian coffee, based on the correlation of those prices over past six-month periods.)

815-30-55-4 In assessing hedge effectiveness on an ongoing basis, Entity G also must consider the extent of offset between the change in expected cash flows on its Colombian coffee forward contract and the expected net change in expected cash flows for the forecasted purchase of Brazilian coffee attributable to changes in the contractually specified component. Both changes would be measured on a cumulative basis for actual changes in the forward price of the respective coffees during the hedge period.

815-30-55-5 See Topic 820 (including paragraph 820-10-55-13) for a discussion of expected cash flows.

815-30-55-6 Because the only difference between the forward contract and forecasted purchase relates to the type of coffee (Colombian versus Brazilian), Entity G could consider the changes in the cash flows on a forward contract for Brazilian coffee to be a measure of perfectly offsetting changes in cash flows for its forecasted purchase of Brazilian coffee. For example, for given changes in the U.S. dollar prices of six-month and three-month Brazilian and Colombian contracts, Entity G could compute the effect of a change in the price of coffee on the expected cash flows of its forward contract on Colombian coffee and of a forward contract for Brazilian coffee as follows.

	Estimate of Change in Cash Flows	
	<i>Hedging Instrument: Forward Contract on Colombian Coffee</i>	<i>Estimate of Forecasted Transaction: Forward Contract on Brazilian Coffee</i>
Forward Price of Colombian and Brazilian coffee:		
At hedge inception—6-month price	\$ 2.54	\$ 2.43
3 months later—3-month price	2.63	2.53
Cumulative change in price—gain	\$ 0.09	\$ 0.10
× 500,000 pounds of coffee	× 500,000	× 500,000
Estimate of change in cash flows	\$ 45,000	\$ 50,000

815-30-55-7 See Topic 820 (including paragraph 820-10-55-13) for a discussion of expected cash flows.

815-30-55-8 Using the amounts in paragraph 815-30-55-6, Entity G could evaluate effectiveness 3 months into the hedge on its first subsequent quarterly effectiveness assessment testing date by comparing the \$45,000 change on its Colombian coffee contract with what would have been a perfectly offsetting change in cash flow for its forecasted purchase—the \$50,000 change on an otherwise identical forward contract for Brazilian coffee. Entity G concludes that the hedging relationship would be highly effective, and it would record the \$45,000 change in the fair value of the forward contract on Colombian coffee in other comprehensive income. ~~The hedge would be ineffective to the extent that there was a difference between the changes in the present value of the expected cash flows on the following forward contracts:~~

- a. Subparagraph superseded by Accounting Standards Update No. 2017-12.~~Entity G's Colombian coffee forward contract~~
- b. Subparagraph superseded by Accounting Standards Update No. 2017-12.~~A comparable forward contract for Brazilian coffee (the equivalent of the present value of \$5,000 in the numerical example).~~

> > Example 2: Effectiveness of Cash Flow Hedge with a Basis Swap

815-30-55-9 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to assessing effectiveness ~~and measuring ineffectiveness~~ for a cash flow hedge with a basis swap. Assume that the entity elects to perform subsequent hedge effectiveness assessments on a quantitative basis and that all hedge documentation requirements were satisfied ~~hedge satisfied all of the criteria for hedge accounting at inception.~~

815-30-55-10 Entity H has a 5-year, \$100,000 variable-rate asset and a 7-year, \$150,000 variable-rate liability. The interest on the asset is payable by the counterparty at the end of each month based on the prime rate as of the first of the month. The interest on the liability is payable by Entity H at the end of each month based on **London Interbank Offered Rate (LIBOR)** as of the tenth day of the month (the liability's anniversary date). The reference rates for both the asset and the liability are contractually specified. Entity H enters into a 5-year interest rate swap to pay interest at the prime rate and receive interest at LIBOR at the end of each month based on a **notional amount** of \$100,000. Both rates are determined as of the first of the month. Entity H designates the interest rate swap as a hedge of 5 years of interest receipts on the \$100,000 variable-rate asset and the first 5 years of interest payments on \$100,000 of the variable-rate liability. The hedged risk is ~~the risk of overall changes~~ variability in the contractually specified interest payments received on the asset and paid on the liability, and not interest rate risk.

Assume the likelihood of credit default and the likelihood of principal prepayments each is remote.

815-30-55-11 Entity H may not automatically assume that the hedge always will be highly effective at achieving offsetting changes in cash flows because the reset date on the receive leg of the interest rate swap differs from the reset date on the corresponding variable-rate liability. Both at hedge inception and on an ongoing basis, Entity H's assessment of expected effectiveness could be based on the extent to which changes in LIBOR have occurred during comparable 10-day periods in the past. Entity H's ongoing assessment of ~~expected effectiveness and measurement of actual ineffectiveness~~ would be on a cumulative basis and would incorporate the actual interest rate changes to date. ~~The hedge would be ineffective~~ There will be no perfect offset to the extent that the cumulative change in cash flows on the prime leg of the interest rate swap did not offset the cumulative change in expected cash flows on the asset, and the cumulative change in cash flows on the LIBOR leg of the interest rate swap did not offset the change in expected cash flows on the hedged portion of the liability. The terms of the interest rate swap, the asset, and the portion of the liability that is hedged are the same, with the exception of the reset dates on the liability and the receive leg of the interest rate swap. Thus, ~~the hedge will only be ineffective to the extent that there will be no perfect offset in the hedging relationship if LIBOR has changed between the first of the month (the reset date for the interest rate swap) and the tenth of the month (the reset date for the liability).~~

815-30-55-12 See Topic 820 (including paragraph 820-10-55-13) for a discussion of expected cash flows.

> > Example 3: Effectiveness of Cash Flow Hedge of Forecasted Sale with a Forward Contract

815-30-55-13 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to assessing effectiveness ~~and measuring ineffectiveness~~ for a cash flow hedge of a forecasted sale with a forward contract. Assume that the hedge satisfied all of the criteria for hedge accounting at inception.

815-30-55-14 Entity I, a U.S. dollar (USD) functional currency entity, forecasts the sale of 10,000 units in ~~French francs (FRF)~~ Euros (EUR) of its principal product in 6 months to French customers for ~~FRF~~ EUR 500,000. Entity I wants to hedge the cash flow exposure of the ~~French franc~~ EUR sale related to changes in the USD-EUR ~~FRF~~ exchange rate. It enters into a 6-month forward contract to exchange the ~~FRF~~ EUR 500,000 it expects to receive in the forecasted sale for the USD equivalent specified in the forward contract and designates the forward contract as a cash flow hedge of the forecasted sale.

815-30-55-15 Entity I chooses to assess hedge effectiveness at inception and during the term of the hedge based on the following amounts:

- a. Changes in the **fair value** of the forward contract attributable to changes in the USD-EUR ~~FRF~~ **spot rate**
- b. Changes in the present value of the current USD equivalent of the forecasted receipt of ~~FRF~~ EUR 500,000.

815-30-55-16 Because the critical terms of the forward contract and the {add glossary link}forecasted transaction{add glossary link} are the same, presumably there would be perfect offset ~~no ineffectiveness~~ unless there is a reduction in the expected sales proceeds from the forecasted sales. Because Entity I is assessing effectiveness based on spot rates, it would exclude the change in the fair value of the forward contract attributable to changes in the difference between the forward rate and spot rate from the assessment of effectiveness and account for it through an amortization approach in accordance with paragraph 815-20-25-83A or a mark-to-market approach in accordance with paragraph 815-20-25-83B. Under either approach, the portion of the excluded component recognized in earnings should be presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A ~~measure of hedge ineffectiveness and report it directly in earnings.~~

> > **Example 4: Attempted Hedge of a Forecasted Sale with a Written Call Option**

815-30-55-17 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to an attempted hedge of a forecasted sale with a written call option.

815-30-55-18 Entity J forecasts the sale in 9 months of 100 units of product with a current market price of \$95 per unit. Entity J's objective is to sell the upside potential associated with the forecasted sale by writing a call option for a premium. Entity J plans to use the premium from the call option as an offset to decreases in future cash inflows from the forecasted sale that will occur if the market price of the product decreases below \$95. Accordingly, Entity J sells an at-the-money call option on 100 units of product with a strike price of \$95 for a premium. The premium represents only the time value of the option. The option is exercisable at any time within nine months.

815-30-55-19 Entity J's objective of using the premium from the written call option as an offset to any decrease in future cash inflows does not meet the notion of effectiveness in this Subtopic. Future changes in the market price of the entity's product will not affect the premium that Entity J received, which is all related to time value in this example and thus is the maximum amount by which Entity J can benefit. That is, Entity J cannot expect the cash flows on the option to increase so

that, at different price levels, a decrease in cash flows from the forecasted sale would be offset by an increase in cash flows on the option.

**> > Example 5: Cash Flow Hedge of the Forecasted Sale of a Commodity
When the Critical Terms Match Inventory**

815-30-55-20 This Example illustrates the application of the guidance in paragraphs 815-20-25-84 through 25-85 Subtopic 815-20 and this Subtopic to the accounting for a cash flow hedge of a forecasted sale of a commodity. The terms of the hedging derivative have been negotiated to match the terms of the forecasted transaction. ~~Thus, there is no ineffectiveness.~~ Assume that there is no time value in the derivative instrument. Entity ABC has chosen to hedge the variability of the cash flows from the forecasted sale of the commodity instead of the changes in its fair value. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-21 ~~Because there is no contractually specified component, Entity ABC decides to hedge~~ hedges the risk of changes in its cash flows relating to changes in the sales price of a forecasted sale of 100,000 bushels of Commodity A by entering into a derivative instrument, Derivative Z. Entity ABC expects to sell the 100,000 bushels of Commodity A on the last day of Period 1. On the first day of Period 1, Entity ABC enters into Derivative Z and designates it as a cash flow hedge of the forecasted sale. Entity ABC neither pays nor receives a premium on Derivative Z (that is, its fair value is zero). ~~The hedging relationship qualifies for cash flow hedge accounting.~~ Entity ABC expects that there will be perfect offset between the hedging instrument and the hedged item ~~no ineffectiveness from the hedge~~ because all of the following conditions exist:

- a. The notional amount of Derivative Z is 100,000 bushels and the forecasted sale is for 100,000 bushels.
- b. The **underlying** of Derivative Z is the price of the same variety and grade of Commodity A that Entity ABC expects to sell (assuming delivery to Entity ABC's selling point).
- c. The settlement date of Derivative Z is the last day of Period 1 and the forecasted sale is expected to occur on the last day of Period 1.

The entity need not perform an initial quantitative assessment of hedge effectiveness in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) because the conditions in paragraphs 815-20-25-84 through 25-85 are met.

815-30-55-22 At inception of the hedge, the expected sales price of 100,000 bushels of Commodity A is \$1,100,000. On the last day of Period 1, the fair value of Derivative Z has increased by \$25,000, and the expected sales price of 100,000 bushels of Commodity A has decreased by \$25,000. Both the sale of 100,000

bushels of Commodity A and the settlement of Derivative Z occur on the last day of Period 1. The following table illustrates the accounting, including the net ~~impact~~ effect on earnings and other comprehensive income, for the situation described.

	Debit (Credit)			
	Cash	Derivative	Other Comprehensive Income	Earnings ^(a)
Recognize change in fair value of derivative		\$ 25,000	\$ (25,000)	
Recognize revenue from sale	\$ 1,075,000			\$ (1,075,000)
Recognize settlement of derivative	\$25,000	(25,000)		
Reclassify change in fair value of derivative to earnings			25,000	(25,000)
Total	\$ 1,100,000	\$ -	\$ -	\$ (1,100,000)

(a) The change in fair value of the hedging derivative is presented in the same income statement line item as the earnings effect of the hedged item.

815-30-55-23 At the inception of the hedge, Entity ABC anticipated that it would receive \$1,100,000 from the sale of 100,000 bushels of Commodity A. This Example illustrates that by hedging the risk of changes in its cash flows relating to the forecasted sale of 100,000 bushels of Commodity A, Entity ABC still received a total of \$1,100,000 in cash flows even though the sales price of Commodity A declined during the period.

> > **Example 6: Cash Flow Hedge of Variable-Rate Interest-Bearing Asset**

815-30-55-24 This Example demonstrates the mechanics of accounting for an interest rate swap used as a cash flow hedge of variable interest receipts in accordance with the guidance in Subtopic 815-20 and this Subtopic. It is not intended to demonstrate how to compute the fair value of an interest rate swap. As in Example 8 (see paragraph 815-25-55-40), the **zero-coupon method** is used to determine the fair values. (Unlike in that Example, the yield curve in this Example is assumed to be upward sloping, that is, interest rates are higher for payments due further into the future.) In this Example, the term, notional amount, and repricing date of the interest rate swap match the term, repricing date, and principal amount of the interest-bearing asset on which the hedged interest receipts are due. The swap terms are at the market (as described in paragraphs 815-20-25-104, 815-20-25-106, and 815-20-25-109 ~~through 25-110~~), so it has a zero value at inception. Thus, the reporting entity is permitted to assume that the hedging relationship will achieve perfect offset in the variability of cash flows of the hedged item ~~there will be no ineffectiveness~~.

815-30-55-25 As discussed beginning in paragraph 815-20-25-102, a shortcut method can be used to produce the same reporting results as the method illustrated in this Example. This shortcut is ~~only~~ appropriate only if the assumption of ~~no ineffectiveness~~ perfect offset applies for an interest rate swap used as a cash

flow hedge of interest receipts on a variable-rate asset (or interest payments on a variable-rate liability). The steps in the shortcut method are as follows:

- a. Determine the difference between the variable rate to be paid on the interest rate swap and the variable rate to be received on the bonds.
- b. Combine that difference with the fixed rate to be received on the interest rate swap.
- c. Compute and recognize interest income using that combined rate and the variable-rate asset's principal amount. (Amortization of any purchase premium or discount on the asset must also be considered, although that complication is not incorporated in this Example.)
- d. Determine the fair value of the interest rate swap.
- e. Adjust the carrying amount of the interest rate swap to its fair value and adjust other comprehensive income by an offsetting amount.

A slightly different shortcut method for interest rate swaps used as **fair value hedges** is illustrated in Example 8 (see paragraph 815-25-55-40).

815-30-55-26 For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-27 On July 1, 20X1, Entity XYZ invests \$10,000,000 in variable-rate corporate bonds that pay interest quarterly at a rate equal to the 3-month USD LIBOR rate plus 2.25 percent. The \$10,000,000 principal will be repaid on June 30, 20X3.

815-30-55-28 Also on July 1, 20X1, Entity XYZ enters into a two-year receive-fixed, pay-variable interest rate swap and designates it as a hedging instrument in a cash flow hedge of the variable-rate interest receipts on the corporate bonds. The risk designated as being hedged is the risk of changes variability in cash flows received attributable to changes in the contractually specified interest rate, designated benchmark interest rate. Entity XYZ designates changes in LIBOR swap rates as the benchmark interest rate in hedging interest rate risk. The terms of the interest rate swap and the corporate bonds are shown in the following table.

	<u>Interest Rate Swap</u>	<u>Corporate Bonds</u>
Trade date and borrowing date ^(a)	July 1, 20X1	July 1, 20X1
Termination date	June 30, 20X3	June 30, 20X3
Notional amount	\$10,000,000	\$10,000,000
Fixed interest rate	6.65%	Not applicable
Variable interest rate ^(b)	3-month USD LIBOR	3-month USD LIBOR + 2.25%
Settlement dates and interest payment dates ^(a)	End of each calendar quarter	End of each calendar quarter
Reset dates	End of each calendar quarter through March 31, 20X3	End of each calendar quarter through March 31, 20X3

(a) These terms need not match for the assumption of ~~no ineffectiveness~~ perfect offset to be appropriate. (See paragraphs 815-20-25-102 through 25-110.)

(b) Only the interest rate basis (for example, LIBOR) must match. The spread over LIBOR does not invalidate the assumption of perfect offset ~~no ineffectiveness~~.

815-30-55-29 Because the conditions described in paragraphs 815-20-25-104 and 815-20-25-106 are met, Entity XYZ is permitted to assume that there is ~~no ineffectiveness~~ perfect offset in the hedging relationship and to recognize in other comprehensive income the entire change in the fair value of the interest rate swap.

815-30-55-30 The three-month USD LIBOR rates in effect at the inception of the hedging relationship and at each of the quarterly reset dates are assumed to be as follows.

<u>Reset Date</u>	<u>3-Month LIBOR Rate</u>
7/1/X1	5.56%
9/30/X1	5.63%
12/31/X1	5.56%
3/31/X2	5.47%
6/30/X2	6.75%
9/30/X2	6.86%
12/31/X2	6.97%
3/31/X3	6.57%

815-30-55-31 Entity XYZ must reclassify to earnings the amount in accumulated other comprehensive income as each interest receipt affects earnings. In determining the amounts to reclassify each quarter, it is important to recognize that the interest rate swap does not hedge the bonds. Instead, it hedges the eight variable interest payments to be received. That is, each of the eight quarterly settlements on the swap is associated with an interest payment to be received on the bonds. Under the zero-coupon method discussed in paragraph 815-30-55-24, the present value of each quarterly settlement is computed separately. Because each payment occurs at a different point on the yield curve, a different interest rate must be used to determine its present value. As each individual interest receipt on

the bonds is recognized in earnings, the fair value of the related quarterly settlement on the swap is reclassified to earnings. The fair values and changes in fair values of the interest rate swap and the effects on earnings and other comprehensive income for each quarter are as follows.

	Swap Debit (Credit)	Other Comprehensive Income Debit (Credit)	Earnings Debit (Credit)	Cash Debit (Credit)
July 1, 20X1	\$ -			
Interest accrued	-			
Payment (receipt)	(27,250)			\$ 27,250
Effect of change in rates	52,100	\$ (52,100)		
Reclassification to earnings		27,250	\$ (27,250)	
September 30, 20X1	24,850	(24,850)	\$ (27,250)	\$ 27,250
Interest accrued	330	(330)		
Payment (receipt)	(25,500)			\$ 25,500
Effect of change in rates	74,120	(74,120)		
Reclassification to earnings		25,500	\$ (25,500)	
December 31, 20X1	73,800	(73,800)	\$ (25,500)	\$ 25,500
Interest accrued	1,210	(1,210)		
Payment receipt	(27,250)			\$ 27,250
Effect of change in rates	38,150	(38,150)		
Reclassification to earnings		27,250	\$ (27,250)	
March 31, 20X2	85,910	(85,910)	\$ (27,250)	\$ 27,250
Interest accrued	1,380	(1,380)		
Payment (receipt)	(29,500)			\$ 29,500
Effect of change in rates	(100,610)	100,610		
Reclassification to earnings		29,500	\$ (29,500)	
June 30, 20X2	(42,820)	42,820	\$ (29,500)	\$ 29,500
Interest accrued	(870)	870		
Payment (receipt)	2,500			\$ (2,500)
Effect of change in rates	8,030	(8,030)		
Reclassification to earnings		(2,500)	\$ 2,500	
September 30, 20X2	(33,160)	33,160	\$ 2,500	\$ (2,500)
Interest accrued	(670)	670		
Payment (receipt)	5,250			\$ (5,250)
Effect of change in rates	6,730	(6,730)		
Reclassification to earnings		(5,250)	\$ 5,250	
December 31, 20X2	(21,850)	21,850	\$ 5,250	\$ (5,250)
Interest accrued	(440)	440		
Payment (receipt)	8,000			\$ (8,000)
Effect of change in rates	16,250	(16,250)		
Reclassification to earnings		(8,000)	\$ 8,000	
March 31, 20X3	1,960	(1,960)	\$ 8,000	\$ (8,000)
Interest accrued	40	(40)		
Payment (receipt)	(2,000)			\$ 2,000
Reclassification to earnings		2,000	\$ (2,000)	
June 30, 20X3	\$ -	\$ -	\$ (2,000)	\$ 2,000

815-30-55-32 The preceding table shows that, in each quarter, the net cash receipt or payment on the swap equals the income or expense to be recorded. The net effect on earnings of the interest on the bonds and the reclassification of gains or losses on the interest rate swap are presented in the same income statement line item as the earnings effect of the hedged item. The net earnings effect is shown in the following table.

For the Quarter Ending	Earnings		
	Gains (Losses)		
	Interest on Bonds	Reclassified from Other Comprehensive Income	Net Effect
9/30/X1	\$ 195,250	\$ 27,250	\$ 222,500
12/31/X1	197,000	25,500	222,500
3/31/X2	195,250	27,250	222,500
6/30/X2	193,000	29,500	222,500
9/30/X2	225,000	(2,500)	222,500
12/31/X2	227,750	(5,250)	222,500
3/31/X3	230,500	(8,000)	222,500
6/30/X3	220,500	2,000	222,500
Totals	<u>\$ 1,684,250</u>	<u>\$ 95,750</u>	<u>\$ 1,780,000</u>

815-30-55-33 In this Example, the shortcut method described in paragraph 815-30-55-25 works as follows. The difference between the variable rate on the interest rate swap and the variable rate on the asset is a net receipt of 2.25 percent. That rate combined with the 6.65 percent fixed rate received on the interest rate swap is 8.9 percent. The computed interest income is \$890,000 per year or \$222,500 per quarter, which is the same as the amount in the table in the preceding paragraph.

>> Example 7: Derivative Instrument’s Gain or Loss in a Cash Flow Hedge—Effectiveness Based on the Entire Change in Fair Value

815-30-55-34 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~This Example has been designed to illustrate application of the guidance for cash flow hedges described in paragraph 815 30 35 3. At the beginning of Period 1, Entity XYZ enters into a qualifying cash flow hedge of a **transaction** forecasted to occur early in Period 6. Entity XYZ’s documented policy is to assess hedge effectiveness by comparing the changes in present value of the expected future cash flows on the forecasted transaction to all of the hedging derivative’s gain or loss (that is, no time value component will be excluded as discussed in paragraphs 815 20 25 81 through 25 83). In this hedging relationship, Entity XYZ has designated changes in cash flows related to the forecasted transaction attributable to any cause as the hedged risk. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise~~

stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-35 Paragraph superseded by Accounting Standards Update No. 2017-12. The following includes the assumptions for this Example and details the steps necessary to account for a cash flow hedge that is not perfectly effective.

Present Value of Expected Future Cash Flows on Hedged Transaction						
Fair Value of Derivative Increase (Decrease)		Hedged Transaction Increase (Decrease)				
(A)	(B)	(C)	(D)	(E)	(F)	
Period	Change during the Period	Cumulative Change	Change during the Period	Cumulative Change	Lesser of the Two Cumulative Changes	
1	\$ 100	\$ 100	\$ (96)	\$ (96)	\$ 96	\$ 96
2	94	194	(101)	(197)	194	98
3	(162)	32	160	(37)	32	(162)
4	(101)	(69)	103	66	(66)	(98)
5	30	(39)	(32)	34	(34)	32

Step 1: Determine the change in fair value of the derivative instrument and the change in present value of the cash flows on the hedged transaction (columns A and C).

Step 2: Determine the cumulative changes in fair value of the derivative instrument and the cumulative changes in present value of the cash flows on the hedged transaction (columns B and D).

Step 3: Determine the lesser of the absolute values of the two amounts in Step 2 (column E).

Step 4: Determine the change during the period in the lesser of the absolute values (column F).

Step 5: Adjust the derivative instrument to reflect its change in fair value and adjust other comprehensive income by the amount determined in Step 4. Balance the entry, if necessary, with an adjustment to earnings.

815-30-55-36 Paragraph superseded by Accounting Standards Update No. 2017-12. The following are the entries required to account for the cash flow hedge.

		Debit (Credit)		
Period	Description	Derivative	Earnings	Other Comprehensive Income
1	Adjust derivative to fair value and in other comprehensive income by the calculated amount	\$ 100	\$ (4)	(96)
2	Adjust derivative to fair value and in other comprehensive income by the calculated amount	94	4	(98)
3	Adjust derivative to fair value and in other comprehensive income by the calculated amount	(162)		162
4	Adjust derivative to fair value and in other comprehensive income by the calculated amount	(101)	3	98
5	Adjust derivative to fair value and in other comprehensive income by the calculated amount	30	2	(32)

815-30-55-37 Paragraph superseded by Accounting Standards Update No. 2017-12. The following table reconciles the beginning and ending balances in accumulated other comprehensive income.

Accumulated Other Comprehensive Income—Debit (Credit)				
Period	Beginning Balance	Change in Fair Value	Reclassification	Ending Balance
1	\$ —	\$ (96)	\$ —	\$ (96)
2	(96)	(94)	(4)	(194)
3	(194)	162	—	(32)
4	(32)	98	—	66
5	66	(30)	(2)	34

815-30-55-38 Paragraph superseded by Accounting Standards Update No. 2017-12. The reclassification column relates to reclassifications between earnings and other comprehensive income. In Period 2, the \$(4) in that column relates to the prior period's derivative instrument gain that was previously recognized in earnings. That amount is reclassified to other comprehensive income in Period 2 because the cumulative gain on the derivative instrument is less than the amount necessary to offset the cumulative change in the present value of expected future cash flows on the hedged transaction. In Period 5, the \$(2) in the reclassification column relates to the derivative instrument loss that was recognized in other comprehensive income in a prior period. At the end of Period 4, the derivative instrument's cumulative loss of \$69 was greater in absolute terms than the \$66 increase in the present value of expected future cash flows on the hedged transaction. That \$3 excess had been recognized in earnings during Period 4. In Period 5, the value of the derivative instrument increased (and reduced the cumulative loss) by \$30. The present value of the expected cash flows on the hedged transaction decreased (and reduced the cumulative increase) by \$32. The gain on the derivative instrument in Period 5 was \$2 smaller, in absolute terms, than the decrease in the present value of the expected cash flows on the hedged transaction. Consequently, the entire gain on the derivative instrument is recognized in other comprehensive income. In addition, in absolute terms, the \$3 cumulative excess of the loss on the derivative instrument over the increase in the present value of the expected cash flows on the hedged transaction (which had previously been recognized in earnings) increased to \$5. As a result, \$2 is reclassified from other comprehensive income to earnings so that the \$5 cumulative excess has been recognized in earnings.

815-30-55-39 Paragraph superseded by Accounting Standards Update No. 2017-12. See Topic 820 (including paragraph 820-10-55-13) for a discussion of expected cash flows.

> > Example 8: Designation and Discontinuance of a Cash Flow Hedge of the Forecasted Purchase of Inventory

815-30-55-40 This Example illustrates the effect on earnings and other comprehensive income of discontinuing a cash flow hedge by dedesignating the hedging derivative under paragraph 815-30-40-1(c) before the variability of the cash flows from the hedged forecasted transaction has been eliminated. It also discusses the effect that the location of a physical asset has on the effectiveness of a hedging relationship. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-41 On February 3, 20X1, Entity JKL forecasts the purchase of 100,000 bushels of corn on May 20, 20X1. The contract does not contain a contractually specified component, and Entity JKL designates changes in cash flows related to the forecasted transaction attributable to all changes in the purchase price as the hedged risk. It expects to sell finished products produced from the corn on May 31, 20X1. On February 3, 20X1, Entity JKL enters into 20 futures contracts, each for the purchase of 5,000 bushels of corn on May 20, 20X1 (100,000 in total), and ~~immediately~~ designates those contracts as a hedging instrument in a cash flow hedge of the forecasted purchase of corn.

815-30-55-42 Entity JKL chooses to assess effectiveness by comparing the entire change in fair value of the futures contracts to changes in the expected cash flows on the forecasted transaction. Entity JKL estimates its expected cash flows on the forecasted transaction based on the futures price of corn adjusted for the difference between the cost of corn delivered to Chicago and the cost of corn delivered to Minneapolis. Entity JKL does not choose to use a tailing strategy (as described in paragraph 815-20-25-121). Entity JKL expects changes in fair value of the futures contracts to be highly effective at offsetting changes in the expected cash outflows for the forecasted purchase of corn because both of the following conditions exist:

- a. The futures contracts are for the same variety and grade of corn that Entity JKL plans to purchase.
- b. On May 20, 20X1, the futures price for delivery on May 20, 20X1 will be equal to the spot price (because futures prices and spot prices converge as the delivery date approaches).

However, the hedge may not achieve perfect offset between the hedged item and hedging instrument because of the difference in the delivery location between the hedging instrument and forecasted transaction ~~be perfectly effective.~~

815-30-55-43 Entity JKL will purchase corn for delivery to its production facilities in Minneapolis, but the price of the futures contracts is based on delivery of corn to Chicago. ~~If the Changes in the difference between the price of corn delivered to Chicago and the price of corn delivered to Minneapolis would result in not achieving perfect offset between the hedged item and hedging instrument and, if of significant magnitude, may preclude the hedging relationship from achieving highly effective offset changes during the period of the hedge, the effect of that change will be included currently in earnings according to the provisions of paragraph 815-30-35-3.~~

815-30-55-44 On February 3, 20X1, the futures price of corn for delivery to Chicago on May 20, 20X1, is \$2.6875 per bushel resulting in a total price of \$268,750 for 100,000 bushels.

815-30-55-45 On May 1, 20X1, Entity JKL dedesignates the related futures contracts and closes them out by entering into offsetting contracts on the same exchange. As of that date, Entity JKL had recognized in accumulated other comprehensive income gains on the futures contracts of \$26,250. Entity JKL still plans to purchase 100,000 bushels of corn on May 20, 20X1. Consequently, the gains that occurred before dedesignation will remain in other comprehensive income until the finished product is sold. If Entity JKL had not closed out the futures contracts when it dedesignated them, any further gains or losses would have been recognized in earnings.

815-30-55-46 On May 20, 20X1, Entity JKL purchases 100,000 bushels of corn, and on May 31, 20X1, Entity JKL sells the finished product.

815-30-55-47 The futures prices of corn that are in effect on key dates are assumed to be as follows.

<u>Date</u>	<u>Futures Price per Bushel for Delivery to Chicago on May 20, 20X1</u>	<u>Futures Price Adjusted for Delivery to Minneapolis on May 20, 20X1</u>
Inception of hedging relationship—February 3, 20X1	\$ 2.6875	\$ 2.7375
End of quarter—March 31, 20X1	3.1000	3.1500
Discontinue hedge—May 1, 20X1	2.9500	3.0000
Purchase of corn—May 20, 20X1	2.8500	2.9000

815-30-55-48 The changes in fair value of the futures contracts between inception (February 3, 20X1) and discontinuation (May 1, 20X1) of the hedge are as follows.

	February 3– March 31, 20X1	April 1– May 1, 20X1
Futures price at beginning of period	\$ 2.6875	\$ 3.1000
Futures price at end of period	3.1000	2.9500
Change in price per bushel	0.4125	(0.1500)
Bushels under contract (20 contracts @ 5,000 bushels each)	× 100,000	× 100,000
Change in fair value—gain (loss)	\$ 41,250	\$ (15,000)

815-30-55-49 The following table displays the entries to recognize the effects of all of the following:

- a. Entering into futures contracts as a hedge of the forecasted purchase of corn
- b. Dedicating and closing out the futures contracts
- c. Completing the forecasted purchase of corn
- d. Selling the finished products produced from the corn.

Because the difference in prices between corn delivered to Chicago and corn delivered to Minneapolis (\$.05 per bushel, as illustrated in paragraph 815-30-55-47) did not change during the period of the hedge, the hedging relationship achieved perfect offset between the hedged item and the hedging instrument so no ineffectiveness is recognized in earnings. If that difference had changed, the entire change in fair value of the futures contracts would still have been recorded in accumulated other comprehensive income until the discontinuation date assuming the hedging relationship remained highly effective at offsetting variability in cash flows and the hedged forecasted transaction was still probable of occurring the resulting ineffectiveness would have been recognized immediately in earnings.

	Debit (Credit)			
	Cash	Inventory	Other Comprehensive Income	Earnings ^(a)
March 31, 20X1 (end of quarter)				
Recognize change in fair value of futures contracts	\$ 41,250		\$ (41,250)	
May 1, 20X1 (discontinue hedge)				
Recognize change in fair value of futures contracts	(15,000)		15,000	
May 20, 20X1				
Recognize purchase of corn	(290,000)	\$ 290,000		
May 31, 20X1				
Recognize cost of sale of product		(290,000)		\$ 290,000
Reclassify changes in fair value of futures contracts to earnings			26,250	(26,250)
Total	<u>\$ (263,750)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 263,750</u>

(a) The change in the fair value of the hedging derivative is presented in the same income statement line item as the earnings effect of the hedged item.

815-30-55-50 To simplify this Example and focus on the effects of the hedging relationship, the margin account with the clearinghouse and certain amounts that would be involved in a sale of Entity JKL's inventory (for example, additional costs of production, selling costs, and sales revenue) have been ignored.

815-30-55-51 The effect of the hedging strategy is that the cost of the corn recognized in earnings when the finished product was sold was \$263,750. If the hedging relationship had not been discontinued early, the cost recognized in earnings would have been \$273,750, which was the futures price of the corn, adjusted for delivery to Minneapolis, at the inception of the hedge. Without the strategy, Entity JKL would have recognized \$290,000, which was the price of corn delivered to Minneapolis at the time it was purchased.

> > Example 9: Changes in a Cash Flow Hedge of Forecasted Interest Payments with an Interest Rate Swap

815-30-55-52 The following Cases describe the effects on earnings and other comprehensive income of certain changes in a cash flow hedging relationship:

- The variability of the hedged interest payments is eliminated before the hedging derivative expires (Case A).
- The interest rate index that is the basis for the hedged interest payments is changed to a different index before the hedging derivative expires (Case B).

815-30-55-53 Cases A and B share the following assumptions. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-54 Entity MNO enters into an interest rate swap (Swap 1) and designates it as a hedge of the variable quarterly interest payments on Entity MNO's 5-year \$5 million borrowing program, initially expected to be accomplished by a series of \$5 million notes with 90-day terms. Entity MNO plans to continue issuing new 90-day notes over the next 5 years as each outstanding note matures. The interest on each note will be determined based on the contractually specified LIBOR rate at the time each note is issued. Swap 1 requires a settlement every 90 days, and the variable interest rate is reset immediately following each payment. Entity MNO pays a fixed rate of interest (6.5 percent) and receives interest at LIBOR. Entity MNO neither pays nor receives a premium at the inception of Swap 1. The notional amount of the contract is \$5 million, and it expires in 5 years.

815-30-55-55 Because Swap 1 and the hedged forecasted interest payments are based on the same notional amount, have the same reset dates, and are based on the same contractually specified benchmark interest rate (that is, the LIBOR rate) designated under paragraph ~~815-20-25-15(i)~~ 815-20-25-15(j)(2), Entity MNO may conclude that there will be no ineffectiveness in the hedging relationship will perfectly offset changes in cash flows of the hedged item attributable to the hedged risk and the hedging instrument (absent a default by the interest rate swap counterparty).

815-30-55-56 This paragraph explains why the guidance in Example 4, Case B (see paragraph 815-20-55-97) does not conflict with the guidance in this Example. In the cash flow hedge in this Example, had the hedged forecasted transaction been narrowly limited to the interest payments on specific future debt issuances rather than on the five-year borrowing program, the failure to engage in future debt issuances would cause the related derivative instrument net gain or loss in other comprehensive income to be immediately reclassified into earnings pursuant to paragraphs 815-30-40-4 through 40-5 because it would have been probable that the hedged forecasted transactions would not occur. Furthermore, if that failure, if is part of a pattern of having hedged forecasted transactions cease being probable of not occurring, it 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, pursuant to paragraph 815-30-40-5. In contrast, in Example 4, Case B (see paragraph 815-20-55-97), the hedged quarterly interest payments were directly linked to Entity B's existing LIBOR-indexed floating-rate assets. When those existing assets are later prepaid or sold, the future quarterly interest payments on those specific assets are no longer probable of occurring (that is, no longer probable of being received by Entity B). Consequently, the hedging relationships for those future quarterly interest payments fail to meet the criterion in paragraph 815-20-25-15(b) and must be discontinued under paragraph 815-30-40-1. Because it is probable that the hedged quarterly interest payments that were directly linked to assets that were prepaid or sold will not occur, the related derivative instrument net gain or loss in other comprehensive income must be immediately reclassified into earnings pursuant to paragraphs 815-30-40-4 through 40-5.

> > > Case A: Variability of Hedged Forecasted Transactions Is Eliminated

815-30-55-57 At the end of the second year of the 5-year hedging relationship, Entity MNO discontinues its practice of issuing 90-day notes. Instead, Entity MNO issues a 3-year, \$5 million note with a fixed rate of interest (7.25 percent). Because the interest rate on the three-year note is fixed, the variability of the future interest payments has been eliminated. Thus, Swap 1 no longer qualifies for cash flow hedge accounting. However, the net gain or loss on Swap 1 in accumulated other comprehensive income is not reclassified to earnings immediately. Immediate reclassification is required (and permitted) only if it becomes probable that the hedged transactions (future interest payments) will not occur. The variability of the payments has been eliminated, but it still is probable that they will occur. Thus, those gains or losses will continue to be reclassified from accumulated other comprehensive income to earnings as the interest payments affect earnings (as required by paragraphs 815-30-35-38 through 35-41) and presented in the same income statement line item as the earnings effect of the hedged item. If the term of the fixed rate note had been longer than three years, the amounts in accumulated other comprehensive income still would have been reclassified into earnings over the next three years, which was the term of the designated hedging relationship.

815-30-55-58 Rather than liquidate the pay-fixed, receive-variable Swap 1, Entity MNO enters into a pay-floating, receive-fixed interest rate swap (Swap 2) with a 3-year term and a notional amount of \$5 million. Entity MNO neither pays nor receives a premium. Like Swap 1, Swap 2 requires a settlement every 90 days and reprices immediately following each settlement. The relationship between 90-day interest rates and longer term rates has changed since Entity MNO entered into Swap 1 (that is, the shape of the yield curve is different). As a result, Swap 2 has different terms and its settlements do not exactly offset the settlements on Swap 1. Under the terms of Swap 2, Entity MNO will receive a fixed rate of 7.25 percent and pay interest at LIBOR.

815-30-55-59 The two swaps are not designated as hedging instruments and are reported at fair value. The changes in fair value are reported immediately in earnings and offset each other to a significant degree.

> > > Case B: Basis of Hedged Forecasted Transactions Is Changed

815-30-55-60 At the end of the second year of the 5-year hedging relationship, Entity MNO discontinues its practice of issuing 90-day notes and issues a 3-year, \$5 million note with a different contractually specified rate of interest rate (that is, an interest rate that is not LIBOR) that adjusts every 90 days to the prime rate quoted on that day. As of this date, Entity MNO must begin performing assessments of effectiveness for the hedging relationship by comparing changes

in fair value of the hedging instrument (indexed to LIBOR) with changes in the value of the hedged item based on the revised contractually specified interest rate. Because the hedged forecasted transactions (future interest payments) are still probable of occurring, Entity MNO may continue to apply hedge accounting in accordance with paragraph 815-30-35-37A if the hedging instrument (indexed to LIBOR) is highly effective at achieving offsetting cash flows attributable to the revised contractually specified interest rate. Swap 1 is no longer effective as a cash flow hedge because the receive variable rate on the swap is LIBOR, and the prime rate and LIBOR are expected to change differently. Thus, the cash flows from the swap will not effectively exactly offset changes in cash flows from the three year note.

815-30-55-61 If the revised hedging relationship is not determined to be highly effective, the hedging relationship must be discontinued. However, the The net gain or loss on Swap 1 in accumulated other comprehensive income as of the date Entity MNO issues the three-year note is not reclassified into earnings immediately. Immediate reclassification would be required only if, as part of its normal process of assessing whether it remains probable that the hedged forecasted transaction will occur, Entity MNO determines that it is it becomes probable that the hedged transactions (future interest payments) will not occur. In this case, the The expected amounts of those payments have changed (because they will be based on prime a revised contractually specified interest rate instead of LIBOR, as originally expected), but it still is probable that the payments will occur. Thus, those gains or losses will continue to be reclassified to earnings as the interest payments affect earnings and presented in the same income statement line item as the earnings effect of the hedged item.

815-30-55-62 Paragraph superseded by Accounting Standards Update No. 2017-12. Rather than liquidate Swap 1 and obtain a separate derivative instrument to hedge the variability of the prime rate based interest payments, Entity MNO enters into a pay-LIBOR, receive prime basis swap. The basis swap has a \$5 million notional amount and a 3 year term and requires a settlement every 90 days. Entity MNO designates Swap 1 and the basis swap in combination as the hedging instrument in a cash flow hedge of the variable interest payments on the three-year note. On the three year note, Entity MNO pays interest at prime. On the basis swap, Entity MNO receives interest at prime and pays interest at LIBOR. On Swap 1, Entity MNO receives interest at LIBOR and pays interest at 6.5 percent. Together, the cash flows from the two derivative instruments are effective at offsetting changes in the interest payments on the three year note. Changes in fair values of the two swaps are recognized in other comprehensive income and are reclassified to earnings when the hedged forecasted transactions (the variable interest payments) affect earnings (as required by paragraphs 815-30-35-38 through 35-41).

> > Example 10: Accounting for a Derivative Instrument's Gain or Loss in a Cash Flow Hedge—Effectiveness Based on Changes in Intrinsic Value

815-30-55-63 This Example illustrates application of the accounting guidance for cash flow hedges described in paragraph 815-30-35-3. At the beginning of Period 1, Entity XYZ purchases for \$9.25 an at-the-money call option on 1 unit of Commodity X with a strike price of \$125.00 to hedge a forecasted purchase of 1 unit of that commodity projected to occur early in Period 5. Entity XYZ's documented policy is to assess hedge effectiveness by comparing changes in expected cash flows on the hedged transaction (based on changes in the Commodity X spot price) with changes in the option contract's intrinsic value. Because the hedging instrument is a purchased call option, its intrinsic value cannot be less than zero. If the price of the commodity is less than the option's strike price, the option is out-of-the-money. Its intrinsic value cannot decrease further regardless of how far the commodity price falls, and the intrinsic value will not increase until the commodity price increases to exceed the strike price. Thus, changes in cash flows from the option due to changes in its intrinsic value will offset changes in cash flows on the forecasted purchase only when the option is in the money or at the money. That phenomenon is demonstrated in Period 3 in the following table when the commodity price declines by \$1.25. Because the commodity price is \$.75 below the option's strike price, the option's intrinsic value declines by only \$.50 (to zero). The effect reverses in Period 4 when the commodity index price increases by \$6.50 and the option's intrinsic value increases by \$5.75. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

	Period 1	Period 2	Period 3	Period 4
Assumptions				
Ending market price of Commodity X	\$ 127.25	\$ 125.50	\$ 124.25	\$ 130.75
Ending fair value of option:				
Time value	\$ 7.50	\$ 5.50	\$ 3.00	\$ -
Intrinsic value	2.25	0.50	-	5.75
Total	\$ 9.75	\$ 6.00	\$ 3.00	\$ 5.75
Change in time value	\$ (1.75)	\$ (2.00)	\$ (2.50)	\$ (3.00)
Change in intrinsic value	2.25	(1.75)	(0.50)	5.75
Total current-period gain (loss) on derivative	\$ 0.50	\$ (3.75)	\$ (3.00)	\$ 2.75
Gain (loss) on derivative, adjusted to remove the component excluded from effectiveness test:				
For the current period	\$ 2.25	\$ (1.75)	\$ (0.50)	\$ 5.75
Cumulative	2.25	0.50	-	5.75
Change in expected future cash flows on hedged transaction:				
For the current period	(2.25)	1.75	1.25	(6.50)
Cumulative	(2.25)	(0.50)	0.75	(5.75)
Balance to be reflected in accumulated other-comprehensive income (paragraph 815-30-35-3(b))				
Lesser (in absolute amounts) of derivative's cumulative gain (loss) or amount necessary to offset the cumulative change in expected future cash flows on hedged transaction	<u>\$ 2.25</u>	<u>\$ 0.50</u>	<u>\$ —</u>	<u>\$ 5.75</u>

815-30-55-64 The following are the entries required to account for the cash flow hedge. Note that consistent with paragraph 815-20-35-1(c), the change in fair value of the hedging instrument that is included in the assessment of hedge effectiveness is recorded in other comprehensive income for qualifying hedging relationships. For this type of hedging relationship, Entity XYZ elects to record changes in the option's time value excluded from the assessment of hedge effectiveness currently in earnings in accordance with paragraph 815-20-25-83B. Amounts recorded in earnings should be presented in the same income statement line item as the earnings effect of the hedged item in accordance with paragraph 815-20-45-1A. The steps involved in determining the amounts are the same as in Example 7 (see paragraph 815-30-55-35).

Period	Description	Debit (Credit)		
		Derivative	Earnings	Other Comprehensive Income
1	Adjust derivative to fair value and other comprehensive income by the calculated amount	\$ 0.50	\$ 1.75	\$ (2.25)
2	Adjust derivative to fair value and other comprehensive income by the calculated amount	(3.75)	2.00	1.75
3	Adjust derivative to fair value and other comprehensive income by the calculated amount	(3.00)	2.50	0.50
4	Adjust derivative to fair value and other comprehensive income by the calculated amount	2.75	3.00	(5.75)

815-30-55-65 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~The following table reconciles the beginning and ending balances in accumulated other comprehensive income:~~

Period	Accumulated Other Comprehensive Income—Debit (Credit)		
	Beginning Balance	Change in Intrinsic Value	Ending Balance
1	\$ _____	\$ (2.25)	\$ (2.25)
2	_____ (2.25)	_____ 1.75	_____ (0.50)
3	_____ (0.50)	_____ 0.50	_____
4	_____	_____ (5.75)	_____ (5.75)

815-30-55-66 The amount reflected in earnings relates to the component excluded from the effectiveness test, that is, the time value component. ~~No reclassifications between other comprehensive income and earnings of the type illustrated in Example 7 (see paragraph 815-30-55-35) are required because no hedge ineffectiveness is illustrated in this Example. (The The change in cash flows from the hedged transaction was not fully offset in Period 3. However, that is not considered ineffectiveness. As as described in paragraph 815-20-25-76, a purchased call option is considered effective if it provides one-sided offset. offset.)~~

> > Example 11: Cash Flow Hedge of the Foreign Currency Exposure in a Royalty Arrangement

815-30-55-67 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to a hedging relationship involving a single hedging derivative and three separate forecasted transactions. The three transactions occur on three separate dates, but the payment on receivables related to all three occurs on the same date. The settlement of the hedging derivative will occur on the date the receivable is paid. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-68 Entity DEF's functional currency is the U.S. dollar (USD). Entity ZYX's functional currency is the euro (EUR). Effective January 1, 20X1, Entity DEF enters into a royalty agreement with Entity ZYX that gives Entity ZYX the right to use Entity DEF's technology in manufacturing Product X. On April 30, 20X1, Entity ZYX will pay Entity DEF a royalty of EUR 1 million for each unit of Product X sold by that date. Entity DEF expects Entity ZYX to sell one unit of Product X on January 31, one on February 28, and one on March 31. The forecasted royalty is probable because Entity ZYX has identified a demand for Product X and no other supplier has the capacity to fill that demand.

815-30-55-69 Also on January 1, 20X1, Entity DEF enters into a forward contract to sell EUR 3 million on April 30, 20X1, for a price equal to the forward price of USD 0.6057 per EUR. Entity DEF designates the forward contract as a hedge of the risk of changes in its functional-currency-equivalent cash flows attributable to changes in the EUR-USD exchange rates related to the forecasted receipt of EUR 3 million from the royalty agreement. The spot price and forward price of EUR at January 1, 20X1, and the USD equivalent of EUR 3 million at those prices are assumed to be as follows.

Prices at January 1, 20X1	USD per EUR		USD Equivalent of EUR 3 Million	
Spot price	USD	0.6019	USD	1,805,700
4-month forward price		0.6057		1,817,100

815-30-55-70 Entity DEF will exclude from its assessment of effectiveness the portion of the fair value of the forward contract attributable to the spot-forward difference (the difference between the spot exchange rate and the forward exchange rate). ~~That is, Entity DEF will elects to recognize changes in that portion of the derivative instrument's fair value currently in earnings in accordance with paragraph 815-20-25-83B but will not consider those changes to represent ineffectiveness.~~ Entity DEF will estimate the cash flows on the forecasted transactions based on the current spot exchange rate and will discount that amount. Thus, Entity DEF will assess effectiveness by comparing the following amounts:

- Changes in the fair value of the forward contract attributable to changes in the USD spot price of EUR
- Changes in the present value of the forecasted cash flows based on the current spot exchange rate.

815-30-55-71 Those two changes will exactly offset because the currency and the notional amount of the forward contract match the currency and the total of the expected foreign currency amounts of the forecasted transactions. Thus, if Entity DEF dedesignates a proportion of the forward contract each time a royalty is

recognized (as described in the following paragraph), the hedging relationship will meet the highly effective criterion.

815-30-55-72 As each royalty is recognized, Entity DEF recognizes a receivable and royalty income. The forecasted transaction (the recognition of royalty income) has occurred. The receivable is an asset, not a forecasted transaction, and would separately be eligible to be designated as a fair value hedge of **foreign exchange risk** or continue to be eligible as a cash flow hedge of foreign exchange risk. Consequently, if the variability of the functional currency cash flows related to the royalty receivable is not being hedged, Entity DEF will dedesignate a proportion of the hedging instrument in the original ~~hedge~~ hedging relationship with respect to the proportion of the forward contract corresponding to the recognized royalty. As the royalty is recognized in earnings and each proportion of the derivative instrument is dedesignated, the related derivative instrument gain or loss in accumulated other comprehensive income is reclassified into earnings and presented in the same income statement line item as the earnings effect of the hedged item. After that date, any gain or loss on the dedesignated proportion of the derivative instrument and any transaction loss or gain on the royalty receivable will be recognized in earnings and may substantially offset each other.

815-30-55-73 Subtopic 830-20 requires immediate recognition in earnings of any foreign currency transaction gain or loss on a foreign-currency-denominated receivable that is not designated as a hedging instrument. Therefore, the effect of changes in spot prices on the royalty receivable must be recognized immediately in earnings.

815-30-55-74 The spot prices and forward prices for settlement on April 30, 20X1, in effect at inception of the hedge (January 1, 20X1) and at the end of each month between inception and April 30, 20X1, are assumed to be as follows.

USD per EUR				
Spot Price			Forward Price for Settlement on 4/30/X1	
January 1	USD	0.6019	USD	0.6057
January 31		0.5970		0.6000
February 28		0.5909		0.5926
March 31		0.5847		0.5855
April 30		0.5729		0.5729

815-30-55-75 The changes in fair value of the forward contract that are recognized each month in earnings and other comprehensive income are shown in the following table. Amounts reclassified from accumulated other comprehensive income to earnings and amounts excluded from the assessment of hedge effectiveness are presented in the same income statement line item as the earnings effect of the hedged item. The fair value of the forward is the present value of the difference between the USD to be received on the forward (USD 1,817,100) and the USD equivalent of EUR 3 million based on the current forward rate. A 6 percent discount rate is used in this Example.

	Debit (Credit)		
	Forward Contract	Earnings	Other Comprehensive Income
Fair value on January 1	\$ -		
Period ended January 31:			
Change in spot-forward difference	2,364	\$ (2,364)	
Change in fair value of dedesignated proportion	-	-	
Change in fair value of designated proportion	14,482		\$ (14,482)
Reclassification of gain	-	(4,827)	4,827
Fair value on January 31	<u>16,846</u>		
Period ended February 28:			
Change in spot-forward difference	3,873	(3,873)	
Change in fair value of dedesignated proportion	6,063	(6,063)	
Change in fair value of designated proportion	12,127		(12,127)
Reclassification of gain	-	(10,891)	10,891
Fair value on February 28	<u>38,909</u>		
Period ended March 31:			
Change in spot-forward difference	2,718	(2,718)	
Change in fair value of dedesignated proportion	12,448	(12,448)	
Change in fair value of designated proportion	6,223		(6,223)
Reclassification of gain	-	(17,114)	17,114
Fair value on March 31	<u>60,298</u>		
Period ended April 30:			
Change in spot-forward difference	2,445	(2,445)	
Change in fair value of dedesignated proportion	35,657	(35,657)	
Change in fair value of designated proportion	-		-
Fair value on April 30	<u>\$ 98,400</u>		
Cumulative effect		<u>\$ (98,400)</u>	<u>-</u>

815-30-55-76 The effect on earnings of the royalty agreement and hedging relationship illustrated in this Example is summarized by month in the following table.

Amounts Recognized in Earnings Related to						
Period Ended	Receivable		Forward Contract			
	USD Equivalent of EUR 1 Million Royalty	Foreign Currency Transaction Gain (Loss)	Amount Attributable to the Dedesignated Proportion	Reclassifications from Other Comprehensive Income	Amount Attributable to the Difference between the Spot and Forward Rates	Total Amount Reported in Earnings
January 31	\$ 597,000	\$ -	\$ -	\$ 4,827	\$ 2,364	\$ 604,191
February 28	590,900	(6,100)	6,063	10,891	3,873	605,627
March 31	584,700	(12,400)	12,458	17,104	2,718	604,580
April 30	-	(35,400)	35,657	-	2,445	2,702
	<u>\$ 1,772,600</u>	<u>\$ (53,900)</u>	<u>\$ 54,178</u>	<u>\$ 38,822</u>	<u>\$ 11,400</u>	<u>\$ 1,817,100</u>
				<u>\$ 98,400</u>		

> > Example 12: Reporting Cash Flow Hedges in Comprehensive Income and Accumulated Other Comprehensive Income

815-30-55-77 This Example illustrates application of the guidance in this Subtopic to reporting cash flow hedges in **comprehensive income** and accumulated other comprehensive income. For simplicity, commissions and most other transaction costs, initial margin, and income taxes are ignored unless otherwise stated. Assume that there are no changes in creditworthiness that would alter the effectiveness of the hedging relationship.

815-30-55-78 Entity TUV's cash flow hedge transactions through the end of 20X4 include all of the following:

- It continually purchases pork belly futures contracts to hedge its anticipated purchases of pork belly inventory.
- In 20X2, it entered into a Euro (EUR) forward exchange contract to hedge the foreign currency risk associated with the expected purchase of a pork belly processing machine with a five-year life that it bought from a vendor in Germany at the end of 20X2.
- In 20X2, it entered into a 10-year interest rate swap concurrent with the issuance of 10-year variable rate debt (cash flow hedge of future variable interest payments).
- In January 20X4, it entered into a two-year Swiss franc (CHF) forward exchange contract to hedge a forecasted export sale (denominated in CHF, expected to occur in December 20X5) of hot dogs to a large customer in Switzerland. In June 20X4, it closed the forward contract, but the forecasted transaction is still expected to occur.

815-30-55-79 The following table reconciles the beginning and ending accumulated other comprehensive income balances for 20X4. It supports the comprehensive income display and disclosures that are required under Topic 220. It is assumed that there are no other amounts in accumulated other comprehensive income. The after-tax amounts assume a 30 percent effective tax rate.

Other Comprehensive Income—Debit (Credit)				
	Accumulated Other Comprehensive Income as of 1/1/X4	Changes in Fair Value Recognized in 20X4	Reclassification Adjustments	Accumulated Other Comprehensive Income as of 12/31/X4
Derivatives designated as hedges of:				
Inventory purchases	\$ 230	\$ 85	\$ (270)	\$ 45
Equipment purchase	120		(30)	90
Variable interest rate payments	(40)	10	5	(25)
Export sale	-	(50)	-	(50)
Before-tax totals	<u>\$ 310</u>	<u>\$ 45</u>	<u>\$ (295)</u>	<u>\$ 60</u>
After-tax totals	<u>\$ 217</u>	<u>\$ 32</u>	<u>\$ (207)</u>	<u>\$ 42</u>

815-30-55-80 The following tables illustrate an acceptable method, under the provisions of Topic 220, of reporting the transactions described by this Example in earnings, comprehensive income, and shareholders' equity.

Effect of Selected Items on Earnings and Comprehensive Income
Year Ended December 31, 20X4

	<u>Debit (Credit)</u>	
Effect on earnings before taxes:		
Cost of goods sold	\$ 270	
Depreciation	30	
Interest	<u>(5)</u>	
Total	295	
Income tax effect	<u>(88)</u> ^(a)	
Effect on earnings after taxes		\$ 207
Other Comprehensive income, net of tax:		
Cash flow hedges:		
Net derivative losses, net of tax effect of \$13	32	
Reclassification adjustments, net of tax effect of \$88	<u>(207)</u>	
Net change		<u>(175)</u>
Effect on total comprehensive income		<u>\$ 32</u>

(a) This Example assumes that it is appropriate under the circumstances, in accordance with Topic 740, to recognize the related income tax benefit in the current year.

Effect of Selected Items on Shareholder's Equity
Year Ended December 31, 20X4
Debit (Credit)

Accumulated other comprehensive income:	
Balance on December 31, 20X3	\$ 217
Net change during the year related to cash flow hedges	<u>(175)</u>
Balance on December 31, 20X4	<u>\$ 42</u>

> > **Example 13: Cash Flow Hedge of a Fixed-Rate Foreign-Currency-Denominated Loan Eliminating Variability in the Functional-Currency-Equivalent Cash Flows (Fixed-to-Fixed Scenario)**

815-30-55-81 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to accounting for a cash flow hedge of a fixed-rate foreign-currency-denominated ~~loan~~ debt in which all of the variability in the functional-currency-equivalent cash flows are eliminated by the effect of the hedge.

815-30-55-82 On July 1, ~~20X1~~ 4999, Entity DEF, a U.S. dollar (USD) functional currency entity, issues a zero-coupon debt instrument with a notional amount of FC 154,766.79 for FC 96,098.00. The interest rate implicit in the debt is 10 percent. The debt will mature on June 30, ~~20X6~~ 2004. Entity DEF enters into a forward contract to buy FC 154,766.79 in 5 years at the forward rate of 1.090148194 (USD 168,718.74) and designates the forward contract as a hedge of the variability of the USD functional currency equivalent cash flows on the debt. Because the currency, notional amount, and maturity of the debt and the forward contract match, the entity concludes that the hedging relationship will achieve perfect offset ~~no ineffectiveness will result~~. The USD interest rate implicit in the forward contract is 11.028 percent. The market data, period end balances, and journal entries from cash flow hedge accounting are as follows.

Period	Spot Rate USD/Functional Currency	Forward Rate USD/Functional Currency	Forward Rate Difference	Foreign Currency Present Value	USD Spot Amounts	USD Debt (@11.028%)	Fair Value Forward USD
0	1.040604383	1.090148194	0	\$ 96,098.00	\$ 100,000.00	\$ 100,000.00	\$ -
1	1.1	1.184985966	0.094837771	105,707.80	116,278.58	111,028.04	9,327.97
2	1.1	1.163142966	0.072994712	116,278.58	127,906.44	123,272.25	8,041.09
3	1.1	1.141702484	0.051554290	127,906.44	140,697.08	136,866.76	6,360.72
4	1.1	1.120657277	0.030509083	140,697.08	154,766.79	151,960.48	4,215.89
5	1.1	1.1	0.009851806	154,766.79	170,243.47	168,718.74	1,524.73

			Cash	Forward	Debt	Other Comprehensive Income	Interest Expense	Transaction Loss
7/1/99	7/1/20X1	Borrow money	\$ 100,000.00		\$ (100,000.00)			
6/30/00	6/30/20X2	Accrue interest on debt			(10,570.78)		\$ 10,570.78	
6/30/00	6/30/20X2	Mark debt to spot			(5,707.80)			\$ (5,707.80)
6/30/00	6/30/20X2	Mark forward to fair value		\$9,327.97		\$ (4,077.43)	457.26	(5,707.80)
6/30/00	6/30/20X2	Balances	100,000.00	9,327.97	(116,278.58)	(4,077.43)	11,028.04	-
6/30/01	6/30/20X3	Accrue interest on debt			(11,627.86)		11,627.86	
6/30/01	6/30/20X3	Mark forward to fair value		(1,286.88)		670.53	616.35	
6/30/01	6/30/20X3	Balances	100,000.00	8,041.08	(127,906.44)	(3,406.90)	23,272.25	
6/30/02	6/30/20X4	Accrue interest on debt			(12,790.64)		12,790.64	-
6/30/02	6/30/20X4	Mark forward to fair value		(1,680.37)		876.50	803.87	
6/30/02	6/30/20X4	Balances	100,000.00	6,360.71	(140,697.08)	(2,530.40)	36,866.76	
6/30/03	6/30/20X5	Accrue interest on debt			(14,069.71)		14,069.71	
6/30/03	6/30/20X5	Mark forward to fair value		(2,144.84)		1,120.83	1,024.01	
6/30/03	6/30/20X5	Balances	100,000.00	4,215.88	(154,766.79)	(1,409.57)	51,960.48	
6/30/04	6/30/20X6	Accrue interest on debt			(15,476.68)		15,476.68	
6/30/04	6/30/20X6	Mark forward to fair value		(2,691.15)		1,409.57	1,281.58	
6/30/04	6/30/20X6	Balances	\$ 100,000.00	\$ 1,524.72	\$ (170,243.47)	\$ -	\$ 68,718.74	-

815-30-55-83 Following are journal entries at inception of the loan and at the end of the first year.

<u>7/1/99 7/1/20X1</u>	<u>Debit</u>	<u>Credit</u>
Cash	\$ 100,000.00	
Functional currency debt at spot		\$ 100,000.00
To record FC borrowing in USD.		
<u>6/30/00 6/30/20X2</u>	<u>Debit</u>	<u>Credit</u>
Interest expense	\$ 10,570.78	
Debt		\$ 10,570.78
To accrue interest. Period end spot rate used for simplicity.		
Transaction loss	\$ 5,707.80	
Debt		\$ 5,707.80
To record a transaction loss on the debt.		
Derivative asset	\$ 9,327.97	
Other comprehensive Income		\$ 9,327.97
To record a derivative instrument at fair value and record <u>effective portion the gain on the derivative</u> in other comprehensive income.		
Other comprehensive income	\$ 5,250.54	
Interest expense	457.26	
Earnings <u>Transaction gain/loss</u>		\$ 5,707.80
To reclassify an amount out of accumulated other comprehensive income to do both of the following:		
a. To increase interest expense to the USD yield of 11.028 percent		
b. To offset the transaction loss on the debt.		

815-30-55-84 Journal entries for the remaining four years are not displayed.

815-30-55-85 This Example would also be relevant for a non-interest-bearing foreign-currency-denominated receivable or payable instrument. An amount based on the rate implicit in the forward contract would be reported in earnings each period. Given the short maturities of many receivables and payables, the amount reported in earnings each period may be small.

> > **Example 14: Reclassifying Amounts from a Cash Flow Hedge of a Forecasted Foreign-Currency-Denominated Intra-Entity Sale**

815-30-55-86 This Example illustrates the application of paragraphs 815-20-25-30 and 815-20-25-39 through 25-41. This Example has the following assumptions:

- a. Parent A is a multinational corporation that has the U.S. dollar (USD) as its functional currency.
- b. Parent A has the following two subsidiaries:
 1. Subsidiary B, which has the Euro (EUR) as its functional currency

2. Subsidiary C, which has the Japanese yen (JPY) as its functional currency.
- c. Subsidiary B manufactures a product and has a forecasted sale of the product to Subsidiary C that will be transacted in JPY.

815-30-55-87 Eventually, Subsidiary C will sell the product to an unrelated third party in JPY. Subsidiary B enters into a forward contract with an unrelated third party to hedge the cash flow exposure of its forecasted intra-entity sale in JPY to changes in the EUR-JPY exchange rate.

815-30-55-88 The transaction in this Example meets the hedge criteria of paragraphs 815-20-25-30 and 815-20-25-39 through 25-41, which permits a derivative instrument to be designated as a hedge of the foreign currency exposure of variability in the functional-currency-equivalent cash flows associated with a forecasted intra-entity foreign-currency-denominated transaction if certain criteria are met. Specifically, the operating unit having the foreign currency exposure (Subsidiary B) is a party to the hedging instrument; the hedged transaction is denominated in JPY, which is a currency other than Subsidiary B's functional currency; and all other applicable criteria in Section 815-20-25 are satisfied.

815-30-55-89 Subsidiary B measures the derivative instrument at fair value and records ~~the effective portion of the gain or loss on the derivative instrument in accumulated other comprehensive income, with the ineffective portion, if any, recorded in current earnings.~~ In the consolidated financial statements, the amount in other comprehensive income representing ~~the effective portion of the gain or loss on a derivative instrument designated in a cash flow hedge of a forecasted foreign-currency-denominated intra-entity sale should be reclassified into earnings in the period that the revenue from the sale of the manufactured product to an unrelated third party is recognized and presented in earnings in the same income statement line item as the earnings effect of the hedged item.~~ The reclassification into earnings in the consolidated financial statements should occur when the forecasted sale affects the earnings of Parent A. Because the consolidated earnings of Parent A will not be affected until the sale of the product by Subsidiary C to the unrelated third party occurs, the reclassification of the amount of derivative gain or loss from other comprehensive income into earnings in the consolidated financial statements should occur upon the sale by Subsidiary C to an unrelated third party.

815-30-55-90 This guidance is relevant only with respect to the consolidated financial statements. In Subsidiary B's separate entity financial statements, the reclassification of the amount of the derivative instrument gain or loss from other comprehensive income into earnings should occur in the period the forecasted intra-entity sale is recorded because Subsidiary B's earnings are affected by the change in the EUR-JPY exchange rate when the sale to Subsidiary C occurs.

> > Example 15: Change-in-Variable-Cash-Flows Method for Assessing Hedge Effectiveness

815-30-55-91 This Example demonstrates the application of the change-in-variable-cash-flows method discussed in paragraph 815-30-35-16 to assess hedge effectiveness to a hedging relationship.

815-30-55-92 An entity designates a receive-variable, pay-fixed interest rate swap with a zero fair value as a hedge of variable interest rate payments on a debt instrument. The variable leg of the interest rate swap is based on the three-month U.S. Treasury rate, and the variable cash flows of the debt are based on three-month LIBOR. Assume that the overall change in fair value of the interest rate swap from inception of the hedge is \$16,300, the present value of the cumulative change in the cash flow on the variable leg of the interest rate swap is a gain (increased cash inflow) of \$16,596, and the present value of the cumulative change in the expected future interest cash flows on the variable-rate liability due to changes in the cash flows expected for the remainder of the hedge term is a loss (increased cash outflow) of \$16,396. (The cumulative changes in expected future cash flows on both the variable leg of the interest rate swap and the variable-rate debt are discounted using the rates applicable to determining the fair value of the derivative instrument.)

815-30-55-93 Paragraph superseded by Accounting Standards Update No. 2017-12. The entity would report in earnings a gain of \$200 as ineffectiveness, representing the amount by which the present value of the cumulative change in the cash flows on the variable leg of the interest rate swap exceeds the present value of the cumulative change in the expected cash flows on the variable-rate debt. The interest rate swap would be recorded at fair value on the balance sheet (asset of \$16,300), and the balance in accumulated other comprehensive income would be adjusted to a credit of \$16,100. In accordance with the requirements of paragraph 815-30-35-3(b), there is no reported ineffectiveness when the present value of the cumulative change in the future expected cash flows on the variable-rate debt exceeds the present value of the cumulative change in the future cash flows on the variable leg of the interest rate swap.

815-30-55-93A The entity assesses effectiveness by comparing the present value of the cumulative change in the cash flow on the variable leg of the interest rate swap of \$16,596 with the present value of the cumulative change in the expected future interest cash flows on the variable-rate liability of \$16,396 and concludes that the hedging relationship is highly effective. As a result, the balance in accumulated other comprehensive income would reflect the cumulative change in the fair value of the swap since hedge inception (\$16,300).

> > Example 16: Impact on Accumulated Other Comprehensive Income of Issuing Debt with a Term That Is Shorter Than Originally Forecasted

815-30-55-94 This Example illustrates the effect on accumulated other comprehensive income of issuing debt with a term that is shorter than originally forecasted.

815-30-55-95 Entity A expects to borrow \$100 million over a 10-year period beginning in 6 months. Entity A initially plans to issue \$100 million of 10-year fixed-rate debt at or near par at the then-current market interest rate; consequently, Entity A will be exposed to variability in cash flows in the future quarterly interest payments on the debt due to changes in **credit risk** and interest rate risk that occur during this 6-month period before issuance. To hedge the risk of changes in these 40 quarterly interest payments attributable to changes in the {add glossary link}benchmark interest rate{add glossary link} for the 6-month period, Entity A does all of the following:

- a. It enters into a derivative instrument (for example, a forward-starting interest rate swap).
- b. It documents that it is hedging the variability in the 40 future quarterly interest payments, attributable to changes in the benchmark interest rate, over the next 10 years related to its 10-year \$100 million borrowing program that begins in 6 months.
- c. It documents that it will assess the effectiveness of the hedging relationship semimonthly on a quantitative basis.

815-30-55-96 Six months after inception of the hedging relationship, Entity A issues debt. However, due to market conditions, Entity A decides in the week before issuance that it will issue \$100 million of fixed-rate debt with a 5-year maturity and quarterly interest payments.

815-30-55-97 When Entity A decides that the term of the debt to be issued will differ from the term of the debt originally expected to be issued, Entity A should not immediately reclassify into earnings the entire net gain or loss in accumulated other comprehensive income related to the derivative instrument. Instead, Entity A must first apply the requirements of paragraph 815-30-35-3 using its originally documented hedging strategy and the newly revised best estimate of the cash flows. ~~That paragraph requires recognition of cumulative ineffectiveness for overhedges. This could result in Entity A reporting a significant amount of ineffectiveness in income (in essence a catch up adjustment) in the period that a change is made in the expected future cash flows on the hedged forecasted transaction from the inception of the hedge. That is, the final measurement under paragraph 815-30-35-3(b)(2) assessment of hedge effectiveness should be based on the most recent best estimate of the hedged forecasted transaction as of the date that a cash flow hedge is discontinued prospectively.~~

815-30-55-98 Entity A's strategy is a cash flow hedge of 40 individual probable quarterly interest payments. A cash flow hedge of future interest payments is a hedge of a series of forecasted transactions; consequently, Entity A must first determine the likelihood of whether and when each forecasted transaction in the series will occur. If at any time during the hedging relationship Entity A determines that it is no longer probable that any of the forecasted transactions in the series will occur by the date (or within the time period) originally specified, it must terminate the original hedging relationship for each of those specific nonprobable forecasted transactions (even if the forecasted transaction will occur within an additional two-month period of time after that originally specified date). ~~At the time that Entity A decides that the term of the fixed rate debt to be issued will be changed from 10 years to 5 years, the impact of that decision on the cumulative change in the hedged future interest payments from the inception of the hedge will be reflected in the application of paragraph 815-30-35-3(b). When Entity A performs its semimonthly assessment of effectiveness for the half month period immediately preceding the issuance of the debt, it could also possibly conclude that the hedging relationship is no longer considered highly effective under paragraph 815-20-25-75 because the actual variability in the hedged interest payments for Years 1-5 is now based on the 5-year borrowing rate—not on 10-year rates as expected at the inception of the hedge when the entity selected the hedging derivative. In that circumstance, the hedging relationship is terminated, and the requirements of paragraph 815-30-35-3 must be applied. After the hedging relationship is terminated, Entity A must determine whether it is probable that any or all of those specific nonprobable forecasted transactions will not occur by the date (or within the time period) originally specified or within an additional two-month period of time thereafter (see paragraphs 815-30-40-4 through 40-5).~~ **[Content amended and moved to paragraph 815-30-55-98A]**

815-30-55-98A When Entity A performs its semimonthly assessment of effectiveness for the half-month period immediately preceding the issuance of the debt, it could also possibly conclude that the hedging relationship is no longer considered highly effective under paragraph 815-20-25-75 because the actual variability in the hedged interest payments for Years 1–5 is now based on the 5-year borrowing rate—not on 10-year rates as expected at the inception of the hedge when the entity selected the hedging derivative. In that circumstance, the hedging relationship is terminated, ~~and the requirements of paragraph 815-30-35-3 must be applied.~~ After the hedging relationship is terminated, Entity A must determine whether it is probable that any or all of those specific nonprobable forecasted transactions will not occur by the date (or within the time period) originally specified or within an additional two-month period of time thereafter (see paragraphs 815-30-40-4 through 40-5). **[Content amended as shown and moved from paragraph 815-30-55-98]**

815-30-55-99 When Entity A originally documented the hedging relationship, it was hedging 40 forecasted transactions (forecasted quarterly interest payments) that would begin in 6 months' time and continue over a 10-year period. In this Example,

Entity A terminates the hedging relationship no later than on the date it issues the 5-year debt (because the variability of the first 20 hedged payments ceases on that date) and must determine the amount, if any, to be reclassified into earnings from accumulated other comprehensive income related to the net derivative gain or loss of the terminated cash flow hedge. Because Entity A issued a 5-year debt instrument, Entity A would determine that it is probable that the first 20 forecasted transactions would occur because they are now contractual obligations. Entity A must determine that it is not probable that any of the last 20 forecasted transactions will not occur to continue reporting the net derivative gain or loss related to these forecasted transactions in accumulated other comprehensive income. At issue is whether it is probable that the five-year debt will not be replaced by new borrowings that will involve the quarterly payment of interest. Provided that the entity determines that it is not probable that any of the original 40 forecasted transactions will not occur, Entity A must apply paragraph 815-30-35-3 and continue to report an amount in accumulated other comprehensive income based on the most recent best estimate of the hedged forecasted transactions related to all 40 forecasted transactions and reclassify an appropriate amount into earnings when each hedged forecasted transaction affects earnings and present those amounts in the same income statement line item as the earnings effect of the hedged item. If Entity A determines that it is probable that any of those forecasted transactions will not occur either by the end of the date (or within the time period) originally specified or within an additional two-month period of time thereafter (see paragraphs 815-30-40-4 through 40-5), Entity A should reclassify into earnings from accumulated other comprehensive income the amount of the net derivative instrument gain or loss related to those specific nonoccurring forecasted transactions. That amount should be equivalent to the portion of the present value of the derivative instrument's cash flows intended to offset the changes in the original forecasted transactions for which Entity A has determined it is probable that they will not occur by the date (or within the time period) originally specified or within an additional two-month period of time thereafter. Thus, the nonoccurrence of one of the hedged forecasted transactions described in this Example could potentially jeopardize Entity A's ability to use cash flow hedge accounting in the future for the situation described.

> > Example 17: Discontinuation of a Cash Flow Hedge

815-30-55-100 The following Cases illustrate the application of paragraphs 815-30-40-4 through 40-5 to changes in timing of a forecasted transaction in relation to an originally specified time period:

- a. Transactions to occur within two months of end of originally specified time period (Case A)
- b. Transactions not to occur within two months of end of originally specified time period (Case B).

815-30-55-101 Cases A and B share the following assumptions. On January 1, an entity enters into a ~~cash flow~~ hedge of the variability in the total cash flows of a forecasted sale of the first 100 units of a specified product during the 3-month period from February 1 to April 30. Gains and losses on the hedging instrument are accumulated in other comprehensive income and reclassified into earnings as sales occur and are presented in the same income statement line item as the earnings effect of the hedged item. However, as of March 10, only 60 units of the product have been sold and the entity determines that it is probable that the sale of the remaining 40 units will not occur by April 30. As a result, the entity must discontinue cash flow hedge accounting under the originally designated hedging relationship as of March 10 (pursuant to paragraph 815-30-40-1(a)).

> > > Case A: Transactions to Occur within Two Months of End of Originally Specified Time Period

815-30-55-102 In this Case, the entity determines that it is probable that the sale of the remaining 40 units will occur by June 20. Based on this new information, the entity is permitted to designate a new cash flow hedge under which subsequent derivative instrument gains and losses would receive cash flow hedge accounting. This Example focuses on the derivative instrument gains and losses that have been accumulated in other comprehensive income at March 10 with respect to the remaining 40 unsold units. The derivative instrument gains or losses accumulated in other comprehensive income related to the sale of the remaining 40 units should not be reclassified into earnings as of March 10 because the entity determined on that date that it is at least reasonably possible that the forecasted transactions will occur within the two-month period following April 30 (the end of the originally specified time period).

> > > Case B: Transactions Not to Occur within Two Months of End of Originally Specified Time Period

815-30-55-103 In this Case, the entity determined on March 10 that it is probable that the sale of the remaining 40 units will not occur by June 30 but it was reasonably possible that the sale would occur in July or August.

815-30-55-104 In that circumstance, the derivative instrument gains or losses accumulated in other comprehensive income related to the sale of the remaining 40 units must be reclassified into earnings as of March 10 because the entity would have determined on that date that it is probable that the forecasted transactions will neither occur by the end of the originally specified time period (that is, April 30) nor within the allowable additional two-month period of time (ending on June 30).

815-30-55-105 Furthermore, the example indicates no extenuating circumstances that could justify applying the exception related to a forecasted transaction that is probable of occurring on a date beyond the additional two-month period of time.

> > Example 18: Cash Flow Hedge of Forecasted Sale or Purchase on Credit

815-30-55-106 This Example illustrates the application of paragraphs 815-30-35-9 and 815-20-25-34 through 25-36, which permit an entity to designate a single cash flow hedge that encompasses the variability of functional-currency-equivalent cash flows attributable to foreign exchange risk related to the settlement of a foreign-currency-denominated receivable or payable resulting from a forecasted sale or purchase on credit.

815-30-55-107 This Example has the following assumptions:

- a. Entity A, a U.S. dollar (USD) functional currency entity, forecasts the purchase of inventory on credit for FC 100,000 in 182 days with settlement of the payable in 227 days. The purchase will occur July 15 on credit; the resulting payable will settle August 29.
- b. Entity A enters into a forward contract to purchase FC 100,000 in 227 days at the forward rate of USD .6614 = FC 1.
- c. Entity A designates a single cash flow hedge that encompasses the variability of functional-currency-equivalent cash flows attributable to foreign exchange risk related to the settlement of the foreign-currency-denominated payable resulting from the forecasted purchase on credit.
- d. After the initial quantitative effectiveness test, Entity A measures elects to assess effectiveness on a quantitative basis based on forward rates.

815-30-55-108 Exchange rates are as follows.

Period	Spot	8/29	7/15
		Forward	Forward
1/14	0.6575	0.6614	0.6605
3/31	0.6757	0.6793	
6/30	0.6689	0.6734	
7/15	0.6761	0.6767	
8/29	0.6798	0.6798	

815-30-55-109 Entity A would record the following journal entries.

	Debit (Credit)					Accum. Other Comprehensive Income
	Cash	Inventory	Forward Contract	Accounts Payable	Earnings	
Inception 1/14	—	—	—	—	—	—
March 31 entry (76 days):						
Mark forward to fair value			\$ 1,703			\$ (1,703)
June 30 entry (91 days):						
Mark forward to fair value			(526)			526
July 15 entries (15 days):						
Inventory purchase		\$ 67,610		\$ (67,610)		
August 29 entries (45 days):						
Mark forward to fair value			663			(663)
Functional currency transaction loss on payable				(370)	\$ 370	
Adjustment for paragraph 815-30-35-3(d) through (f)—offset the functional currency transaction loss					(370)	370
Adjustment for paragraph 815-30-35-3(d) through (f)—effect of hedge (based on implicit interest rate; see paragraph 815-30-55-112)					78	(78)
Settlement of payable	\$ (67,980)			67,980		
Settlement of forward	1,840		(1,840)			
	<u>\$ (66,140)</u>	<u>\$ 67,610</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 78</u>	<u>\$ (1,548)</u>

815-30-55-110 Upon sale of the inventory, Entity A would record cost of goods sold of \$67,610 and reclassify \$1,548 from other comprehensive income to earnings to achieve a net cost of goods sold of \$66,062. The effect of the hedge would result in a net cost to Entity A of \$66,140 for the purchase of the inventory.

815-30-55-111 The amount of the adjustment under paragraph 815-30-35-3(d) is that amount needed to ensure that a net amount in earnings reflects the effect of the hedge through each reporting period up to and including the final settlement of the payable.

815-30-55-112 The amount of cost or income to be ascribed to each period is calculated as follows.

Daily interest rate implicit in the hedging relationship as a result of the forward contract: \$65,750 PV, \$66,140 FV, 227n, i = 0.0026053%

1/14	\$ 65,750	
3/31	65,880	\$130
6/30	66,036	156
7/15	66,062	26
8/29	66,140	78
		<u>\$390</u>

Method using two foreign currency forward exchange rates:

From 1/14 to 7/15		
7/15 Forward Rate .6605		
\$66,050 – \$65,750 =	\$	300
From 7/16 to 8/29		
8/29 Forward Rate .6614		
\$66,140 – \$66,050 =		90
	\$	<u>390</u>

Pro rata method:

From 1/14 to 7/15:		
\$390 × 182/227 =	\$	313
From 7/16 to 8/29:		
\$390 × 45/227 =		77
	\$	<u>390</u>

> > **Example 19: Hedge Accounting in the Consolidated Financial Statements Applied to Internal Derivatives That Are Offset on a Net Basis by Third-Party Contracts**

815-30-55-113 This Example illustrates the application of paragraphs 815-20-25-61 through 25-63, specifically, the mechanism for offsetting risks assumed by a Treasury Center using **internal derivatives** on a net basis with third-party contracts. This Example does not demonstrate the computation of fair values and as such makes certain simplifying assumptions.

815-30-55-114 Entity XYZ is a U.S. entity with the U.S. dollar (USD) as both its functional currency and its reporting currency. Entity XYZ has three subsidiaries: Subsidiary A is located in Germany and has the Euro (EUR) as its functional

currency, Subsidiary B is located in Japan and has the Japanese yen (JPY) as its functional currency, and Subsidiary C is located in the United Kingdom and has the pound sterling (GBP) as its functional currency. Entity XYZ uses its Treasury Center to manage foreign exchange risk on a centralized basis. Foreign exchange risk assumed by Subsidiaries A, B, and C through transactions with external third parties is transferred to the Treasury Center via internal contracts. The Treasury Center then offsets that exposure to foreign currency risk via third-party contracts. To the extent possible, the Treasury Center offsets exposure to each individual currency on a net basis with third-party contracts.

815-30-55-115 On January 1, Subsidiaries A, B, and C decide that various foreign-currency-denominated forecasted transactions with external third parties for purchases and sales of various goods are probable. Also on January 1, Subsidiaries A, B, and C enter into internal foreign currency forward contracts with the Treasury Center to hedge the foreign exchange risk of those transactions with respect to their individual functional currencies. The Treasury Center has the same functional currency as the parent entity (USD).

815-30-55-116 Subsidiaries A, B, and C have the following foreign currency exposures and enter into the following internal contracts with the Treasury Center.

Subsidiary	Functional Currency	Forecasted Exposures	Expected Transaction Date	Internal Contracts with Treasury Center	
				Currency Received	Currency Paid
A (German)	EUR	JPY payable 12,000	Jun 1	JPY 12,000	EUR 115 ^(a)
		GBP receivable 50	Jun 1	EUR 80 ^(a)	GBP 50
B (Japanese)	JPY	USD payable 100	Jun 15	USD 100	JPY 10,160 ^(a)
		EUR receivable 100	Jun 15	JPY 10,432 ^(a)	EUR 100
C (UK)	GPB	USD receivable 330	Jun 30	GBP 201 ^(a)	USD 330

(a) Computed based on forward exchange rates as of January 1.

815-30-55-117 Subsidiaries A, B, and C designate the internal contracts with the Treasury Center as cash flow hedges of their foreign currency forecasted purchases and sales. Those internal contracts may be designated as hedging instruments in the consolidated financial statements if the requirements of this Subtopic are met. From the subsidiaries' perspectives, the requirements of paragraph 815-20-25-61 for foreign currency cash flow hedge accounting are satisfied as follows:

- a. From the perspective of the hedging affiliate, the hedging relationship must meet the requirements of paragraphs 815-20-25-30 and 815-20-25-39 through 25-41 for cash flow hedge accounting. Subsidiaries A, B, and C meet those requirements. In each hedging relationship, the forecasted transaction being hedged is denominated in a currency other than the subsidiary's functional currency, and the individual subsidiary that has the

foreign currency exposure relative to its functional currency is a party to the hedging instrument. In addition, the criteria in Section 815-20-25 ~~845-30-25~~ are met. Specifically, each subsidiary prepares formal documentation of the hedging relationships, including the date on which the forecasted transactions are expected to occur and the amount of foreign currency being hedged. The forecasted transactions being hedged are specifically identified, are probable of occurring, and are transactions with external third parties that create cash flow exposure that would affect reported earnings. Each subsidiary also documents its expectation of high effectiveness based on the internal derivatives designated as hedging instruments.

- b. The affiliate that issues the hedge must offset the internal derivative either individually or on a net basis. The Treasury Center determines that it will offset the exposure arising from the internal derivatives with Subsidiaries A, B, and C on a net basis with third-party contracts. Each currency for which a net exposure exists at the Treasury Center is offset by a third-party contract based on that currency.

815-30-55-118 To determine the net currency exposure arising from the internal contracts with Subsidiaries A, B, and C, the Treasury Center performs the following analysis.

Subsidiary Perspective—Internal Contracts with the Treasury Center					
Subsidiary	Contract with Treasury Center	Currency Received (Currency Paid)			
		EUR	JPY	GBP	USD
A (German)	Internal Contract 1	(115)	12,000		
	Internal Contract 2	80		(50)	
B (Japanese)	Internal Contract 3		(10,160)		100
	Internal Contract 4	(100)	10,432		
C (UK)	Internal Contract 5			201	(330)
Net exposure		(135)	12,272	151	(230)

Treasury Center Perspective—Internal Contracts with the Subsidiaries					
Subsidiary	Contract with Treasury Center	Currency Received (Currency Paid)			
		EUR	JPY	GBP	USD
A (German)	Internal Contract 1	115	(12,000)		
	Internal Contract 2	(80)		50	
B (Japanese)	Internal Contract 3		10,160		(100)
	Internal Contract 4	100	(10,432)		
C (UK)	Internal Contract 5			(201)	330
Net exposure		135	(12,272)	(151)	230

815-30-55-119 For Subsidiaries A, B, and C to designate the internal contracts as hedging instruments in the consolidated financial statements, the Treasury Center must meet certain required criteria outlined in paragraphs 815-20-25-62 through 25-63 in determining how it will offset exposure arising from multiple internal derivatives that it has issued. Based on a determination that those requirements

are satisfied (see the following paragraph, the Treasury Center determines the net exposure in each currency with respect to USD (its functional currency). The Treasury Center determines that it will enter into the following three third-party foreign currency forward contracts. The Treasury Center enters into the contracts on January 1. The contracts mature on June 30.

Treasury Center's Contracts with Unrelated Third Parties				
	Currency Bought (Currency Sold)			
	EUR	JPY	BP	USD
Third-Party Contract 1	(135)			138 ^(a)
Third-Party Contract 2		12,272		(121) ^(a)
Third-Party Contract 3			151	(247) ^(a)
Net exposure	(135)	12,272	151	(230)

(a) Computed based on forward exchange rates as of January 1.

815-30-55-120 From the Treasury Center's perspective, the required criteria in paragraphs 815-20-25-62 through 25-63 are satisfied as follows:

- a. The issuing affiliate enters into a derivative instrument with an unrelated third party to offset, on a net basis for each foreign currency, the foreign exchange risk arising from multiple internal derivatives, and the derivative instrument with the unrelated third party generates equal or closely approximating gains and losses when compared with the aggregate or net losses and gains generated by the derivative instruments issued to affiliates. The Treasury Center enters into third-party derivative instruments to offset the exposure of each foreign currency on a net basis. The Treasury Center offsets 100 percent of the net exposure to each currency; that is, the Treasury Center does not selectively keep any portion of that exposure. In this Example, the Treasury Center's third-party contracts generate losses that are equal to the losses on internal contracts designated as hedging instruments by Subsidiaries A, B, and C (see analysis beginning in the following paragraph).
- b. Internal derivatives that are not designated as hedging instruments and all nonderivative instruments are excluded from the determination of the foreign currency exposure on a net basis that is offset by the third-party derivative instrument. The Treasury Center does not include in the determination of net exposure any internal derivatives not designated as hedging instruments or any nonderivative instruments.
- c. Foreign currency exposure that is offset by a single net third-party contract arises from internal derivatives that involve the same currency and that mature within the same 31-day period. The offsetting net third-party derivative instrument related to that group of contracts must offset the aggregate or net exposure to that currency, must mature within the same 31-day period, and must be entered into within 3 business days

after the designation of the internal derivatives as hedging instruments. The Treasury Center's third-party net contracts involve the same currency (that is, not a tandem currency) as the net exposure arising from the internal derivatives issued to Subsidiaries A, B, and C. The Treasury Center's third-party derivative instruments mature within the same 31-day period as the internal contracts that involve currencies that are offset on a net basis. In this Example, for simplicity, all internal contracts and third-party derivative instruments are entered into on the same date.

- d. The issuing affiliate tracks the exposure that it acquires from each hedging affiliate and maintains documentation supporting linkage of each derivative instrument and the offsetting aggregate or net derivative instrument with an unrelated third party. The Treasury Center maintains documentation supporting linkage of third-party contracts and internal contracts throughout the hedge period.
- e. The issuing affiliate does not alter or terminate the offsetting derivative instrument with an unrelated third party unless the hedging affiliate initiates that action. If the issuing affiliate does alter or terminate the offsetting third-party derivative (which should be rare), the hedging affiliate must prospectively cease hedge accounting for the internal derivatives that are offset by that third-party derivative. Based on Entity XYZ's policy, the Treasury Center may not alter or terminate the offsetting derivative instrument with an unrelated third party unless the hedging affiliate initiates that action.
- f. If an internal derivative that is included in determining the foreign currency exposure on a net basis is modified or dedesignated as a hedging instrument, compliance must be reassessed. For simplicity, this Example does not involve a modification or dedesignation of an internal derivative.

815-30-55-121 At the end of the quarter, each subsidiary determines the functional currency gains and losses for each contract with the Treasury Center.

Subsidiary	Contract with Treasury Center	Beginning of Period Functional Currency Amount	End of Period Functional Currency Amount	Functional Currency	US Dollar
		Receive (Pay) ^(a)	Receive (Pay) ^(a)	Gain (Loss) ^(b)	Gain (Loss) ^(c)
A (German)	Internal Contract 1	(115)	(115)	-	-
	Internal Contract 2	80	83	(3)	(3)
B (Japanese)	Internal Contract 3	(10,160)	(10,738)	578	5
	Internal Contract 4	10,432	10,421	11	-
C (UK)	Internal Contract 5	201	204	(3)	(5)
Net USD Gain (Loss)					(3)

(a) Computed based on forward exchange rates as of January 1 and March 31.

(b) For simplicity, functional currency gains or losses are not discounted in this Example.

(c) Functional currency gains and losses converted to USD based on current spot rates.

815-30-55-122 At the end of the quarter, the Treasury Center determines its gains or losses on third-party contracts.

Contracts with Third Parties	Beginning of Period USD	End of Period USD Amount	USD Gain (Loss) ^(b)
	Amount Receive (Pay) ^(a)	Receive (Pay) ^(a)	
Third-Party Contract 1	138	131	7
Third-Party Contract 2	(121)	(114)	(7)
Third-Party Contract 3	(247)	(244)	(3)
	Net USD Gain (Loss)		(3)

(a) Computed based on forward exchange rates as of January 1 and March 31.

(b) For simplicity, gains or losses are not discounted in this Example.

815-30-55-123 Journal Entries at March 31 (Note: All journal entries are in USD.)

Subsidiaries' Journal Entries

German Subsidiary A

There is no entry for Contract 1 because the USD gain or loss is zero.

Other comprehensive income	\$	3	
Derivative liability			\$ 3
To record the loss on Internal Contract 2.			

Japanese Subsidiary B

Derivative asset	\$	5	
Other comprehensive income			\$ 5
To record the gain on Contract 3.			

There is no entry for Internal Contract 4 because the USD gain or loss is zero.

UK Subsidiary C

Other comprehensive income	\$	5	
Derivative liability			\$ 5
To record the loss on Internal Contract 5.			

Treasury Center's Journal Entries

Journal Entries for Internal Contracts with Subsidiaries

There is no entry for Internal Contract 1 because the USD gain or loss is zero.

Derivative asset	\$	3	
Earnings			\$ 3
To record the gain on Internal Contract 2 with German Subsidiary A.			

Earnings	5		
Derivative liability			5
To record the loss on Internal Contract 3 with Japanese Subsidiary B.			

There is no entry for Internal Contract 4 because the USD gain or loss is zero.

Derivative asset	5		
Earnings			5
To record the gain on Internal Contract 5 with UK Subsidiary C.			

Journal Entries for Third-Party Contracts

Derivative asset	\$	7	
Earnings			\$ 7
To record the gain on Third-Party Contract 1.			

Earnings	7		
Derivative liability			7
To record the loss on Third-Party Contract 2.			

Earnings	3		
Derivative liability			3
To record the loss on Third-Party Contract 3.			

Results in Consolidation

Derivative asset	\$	7	
Other comprehensive income		3	
Derivative liability			\$ 10

815-30-55-124 In consolidation, the amounts in the balance sheets of Subsidiaries A, B, and C reflecting derivative instrument assets and derivative instrument liabilities arising from internal derivatives acquired from the Treasury Center eliminate against the Treasury Center's derivative instrument liabilities and derivative instrument assets arising from internal derivatives issued to the subsidiaries. The amount reflected in consolidated other comprehensive income reflects the net entry to other comprehensive income of Subsidiaries A, B, and C. The Treasury Center's gross derivative instrument asset and gross derivative instrument liability arising from third-party contracts are also reflected in the consolidated balance sheet. Based on the assumptions in this Example, the Treasury Center's net loss on third-party derivative instruments used to offset the exposure, on a net basis, of internal contracts with Subsidiaries A, B, and C equals the net loss on internal contracts with the subsidiaries. Therefore, within the Treasury Center, the gains on internal contracts issued to Subsidiaries A, B, and C, and the losses on third-party contracts are equal and offsetting. ~~However, if~~ If the Treasury Center's net gain or loss on third-party contracts does not equal the net gain or loss on internal derivatives designated as hedging instruments by affiliates, the difference must be recognized in consolidated other comprehensive income as ineffectiveness in consolidated earnings.

815-30-55-125 The reclassification of amounts out of consolidated other comprehensive income is based on Subsidiaries A, B, and C's internal contracts with the Treasury Center. That is, the reclassification of amounts out of consolidated other comprehensive income into earnings is based on the timing and amounts of the individual subsidiaries' forecasted transactions. In this Example, at June 30, the forecasted transactions at Subsidiaries A, B, and C have been consummated and the net debit amount in consolidated other comprehensive income of 3 has been reversed.

> > Example 20: Amounts Reclassified into Earnings for Purchased Option Used in a Cash Flow Hedge

815-30-55-126 This Example illustrates when ~~the portion of~~ the hedging instrument's gain or loss that is reported in accumulated other comprehensive income should be reclassified out of accumulated other comprehensive income into earnings under paragraph 815-30-35-36.

815-30-55-127 An entity forecasts that 1 year later it will purchase 1,000 ounces of gold at then current market prices for use in its operations. The entity wishes to protect itself against increases in the cost of gold above the current market price of \$275 per ounce. The entity purchases a 1-year cash-settled at-the-money gold option on 1,000 ounces of gold, paying a premium of \$10,000. If the price of gold is above \$275 at the maturity (settlement) date, the counterparty will pay the entity 1,000 times the difference. If the price of gold is \$275 or below at the maturity date, the contract expires worthless. The option cannot be exercised before its

contractual maturity date. The entity designates the purchased option contract as a hedge of the variability in the purchase price (cash outflow) of the 1,000 ounces of gold for prices above \$275 per ounce. The entity would reclassify the purchased option's gain or loss that is reported in accumulated other comprehensive income in earnings when the cost of the gold affects earnings (such as being included in cost of goods sold) and present that gain or loss in the same income statement line item as the earnings effect of the hedged item.

> > Example 21: Effect on Accumulated Other Comprehensive Income from Issuing Debt at a Date That Is Not the Same as Originally Forecasted

815-30-55-128 The following Cases illustrate the application of paragraph 815-30-40-5 in determining whether an entity should immediately reclassify into earnings the entire net gain or loss related to the derivative instrument in accumulated other comprehensive income when issuing debt at a date that is not the same as originally forecasted:

- a. Amounts are not reclassified immediately into earnings (Case A).
- b. Amounts are reclassified immediately into earnings (Case B).

> > > Case A: Amounts Are Not Reclassified Immediately into Earnings

815-30-55-129 This Case has the following assumptions:

- a. Entity A expects to borrow \$100 million over a 10-year period beginning in 6 months.
- b. Entity A initially plans to issue \$100 million of 10-year fixed-rate debt at or near par at the then-current market interest rate.
- c. Entity A will be exposed to variability in cash flows for the future quarterly interest payments on the debt due to changes in credit risk and interest rate risk that occur during this six-month period before issuance.
- d. To hedge the risk of changes in these 40 quarterly interest payments attributable to changes in the benchmark interest rate for the 6-month period, Entity A does both of the following:
 1. Enters into a derivative instrument (for example, a forward-starting interest rate swap)
 2. Documents that it is hedging the variability in the 40 future quarterly interest payments, attributable to changes in the benchmark interest rate, over the next 10 years related to its 10-year \$100 million borrowing program that begins in 6 months.
- e. Entity A documents that it will assess the effectiveness of the hedging relationship semimonthly on a quantitative basis.
- f. Six months after inception of the hedging relationship, Entity A decides to delay the issuance of the 10-year debt for 3 months.

815-30-55-130 When Entity A decides to delay the issuance of the 10-year debt for 3 months, Entity A should not immediately reclassify into earnings the entire net gain or loss in accumulated other comprehensive income related to the derivative instrument. Entity A's strategy is a cash flow hedge of 40 individual probable quarterly interest payments. A cash flow hedge of future interest payments is a hedge of a series of forecasted transactions; consequently, Entity A must first determine the likelihood of whether and when each forecasted transaction in the series will occur. If at any time during the hedging relationship Entity A determines that it is no longer probable that any of the forecasted transactions in the series will occur by the date (or within the time period) originally specified, it must terminate the original hedging relationship for each of those specific nonprobable forecasted transactions—even if the forecasted transaction will occur within an additional two-month period of time after that originally specified date. Entity A need not terminate the original hedging relationship for those specific forecasted transactions that remain probable of occurring by the date or within the time period originally specified. After the hedging relationship is terminated, Entity A must determine whether it is probable that any or all of those specific nonprobable forecasted transactions will not occur either by the date (or within the time period) originally specified or within an additional two-month period of time thereafter (see paragraphs 815-30-40-4 through 40-5). Entity A should reclassify into earnings from accumulated other comprehensive income the amount of the net derivative instrument gain or loss related to those specific nonprobable forecasted transactions for which it is probable they will not occur. That amount should be equivalent to the present value of the derivative instrument's cash flows intended to offset the changes in the original forecasted transactions for which Entity A has determined it is probable that they will not occur by the date (or within the time period) originally specified or within an additional two-month period of time thereafter.

815-30-55-131 In this Case, when Entity A originally documented the hedging relationship, it was hedging 40 forecasted transactions (forecasted interest payments) that would begin in 6 months' time and continue over a 10-year period. Because Entity A did not issue the debt instrument as originally documented, Entity A would determine that it is probable that the first forecasted transaction will not occur at the time forecasted; consequently, Entity A must terminate the original hedging relationship with respect to that first forecasted transaction. However, Entity A would also determine that it is probable that the other 39 forecasted transactions will occur at the time forecasted. After the hedging relationship is terminated for the specific nonprobable first forecasted transaction, Entity A must determine whether it is probable that specific nonprobable first forecasted transaction will not occur by the forecasted date or within an additional two-month period of time thereafter. In this Case, Entity A determines that it is probable that the first hedged quarterly interest payment will not occur within two months of its specified date. The amount reclassified into earnings from accumulated other comprehensive income is the portion of the interest rate swap's net gain or loss equivalent to the present value of the cash flows from the interest rate swap

intended to offset the changes in the first forecasted transaction that is probable not to occur.

> > Case B: Amounts Are Reclassified Immediately into Earnings

815-30-55-132 This Case has the following assumptions:

- a. Entity B expects to issue \$100 million of 10-year, 9 percent debt in 6 months.
- b. Because the debt will have a fixed interest rate of 9 percent, Entity B will not be exposed to variability in the future quarterly interest payments at 9 percent, but it will be exposed to variability in the cash flows received as proceeds on the debt due to changes in credit risk and interest rate risk that occur during the 6-month period before issuance.
- c. To hedge the risk of changes in the total proceeds attributable to changes in the benchmark interest rate, Entity B does both of the following:
 1. Enters into a derivative instrument (for example, a short position in U.S. Treasury note futures contracts)
 2. Documents that it is hedging the variability in the cash proceeds attributable to changes in the benchmark interest rate to be received from the 9 percent fixed-rate debt it will issue in 6 months and that it will assess effectiveness on a quantitative basis.
- d. Because Entity B plans to issue \$100 million of 10-year, 9 percent debt regardless of the then-current interest rate environment, the effect of increases or decreases in interest rates will be reflected in issuing the debt at a discount or a premium, respectively.
- e. Six months after inception of the hedging relationship, Entity B decides to delay the issuance of the debt for three months.

815-30-55-133 This strategy is a cash flow hedge of the variability in proceeds attributable to changes in the benchmark interest rate to be received from the issuance of debt in six months. A cash flow hedge of the proceeds attributable to changes in the benchmark interest rate is a hedge of a single forecasted transaction specified to occur in six months; consequently, when the single forecasted transaction is no longer probable of occurring by the date (or within the time period) originally specified, Entity B must terminate the hedging relationship. After the hedging relationship is terminated, Entity B must determine whether it is probable that the specific nonprobable forecasted transaction will not occur by the date (or within the time period) originally specified or within an additional two-month period of time thereafter. Because Entity B decided to delay the issuance of the debt for a three-month period of time, Entity B concludes that it is probable that the forecasted transaction will not occur by the date (or within the time period) originally specified or within an additional two-month period of time thereafter. Consequently, Entity B should immediately reclassify into earnings the entire net gain or loss related to the derivative instrument in accumulated other

comprehensive income. Given the guidance in paragraph 815-30-40-5, the nonoccurrence of the hedged forecasted transactions described in this Case could potentially jeopardize Entity B's ability to use cash flow hedge accounting in the future for the situation described.

> > Example 22: Assessing Effectiveness of a Cash Flow Hedge of a Forecasted Purchase of Inventory with a Forward Contract (Contractually Specified Component)

815-30-55-134 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic for assessing effectiveness for a cash flow hedge of a forecasted purchase of inventory with a forward contract for which the hedged risk is variability in cash flows attributable to changes in a **contractually specified component**. Assume the entity elects to perform subsequent assessments of hedge effectiveness on a quantitative basis using a cumulative-dollar-offset approach and all hedge documentation requirements were satisfied at inception.

815-30-55-135 Entity J manufactures keys for door locks on buildings and cars. The keys are cut from sheets of metal called *key plates*. Entity J primarily purchases its key plates from Supplier 1 as needed. Supplier 1 and Entity J have an outstanding agreement specifying that the per-unit cost of each key plate will be determined by Supplier 1 on the first business day of each month on the basis of the following pricing formula:

- a. Spot price of COMEX Zinc per pound × 0.2 pounds, plus
- b. Spot price of COMEX Copper per pound × 0.1 pounds, plus
- c. The current cost of refining copper and zinc into key plates, plus
- d. The current cost of transporting the key plates to Entity J.

815-30-55-136 In January 20X1, Entity J expects to purchase 100,000 key plates in July 20X1, which requires 10,000 pounds of copper for the manufacturing process. Entity J decides that it wishes to hedge only the change in value of the price of COMEX Copper used to create the key plates being purchased in July 20X1.

815-30-55-137 On January 15, 20X1, Entity J enters into a forward contract maturing on July 1, 20X1 (that is, the date on which the price of copper used to manufacture the key plates is fixed) to purchase 10,000 pounds of COMEX Copper at \$2.10 per pound. Any settlement amount on the forward contract will be based on the difference between the contract price of \$2.10 per pound and the spot price of COMEX Copper on the maturity date (July 1, 20X1), multiplied by the notional amount of 10,000 pounds.

815-30-55-138 Entity J designates a cash flow hedge in which the hedging instrument is the forward contract, the hedged item is the forecasted purchase of key plates in July 20X1, and the hedged risk is the variability in the purchase price of the key plates attributable to changes in the COMEX Copper price index, which is a contractually specified component within the frame agreement. Entity J documents in its hedge documentation that the requirements to designate variability in cash flows attributable to changes in a contractually specified component as the hedged risk in paragraph 815-20-25-22A are met.

815-30-55-139 Entity J bases its assessment of hedge effectiveness on cumulative changes in the fair value of the hedging instrument and the hedged item attributable to changes in the hedged risk.

815-30-55-140 In assessing hedge effectiveness on an ongoing basis, Entity J must consider the extent of offset between the change in expected cash flows on the hedging instrument (the copper forward contract) and the hedged item attributable to changes in the hedged risk (change in expected cash flows associated with forecasted purchases of key plates attributable to changes in the COMEX Copper price index). The table below illustrates the cumulative changes in the hedging instrument and hedged item attributable to changes in the hedged risk as of the first subsequent quarterly effectiveness assessment date.

[For ease of readability, the new tables in Examples 22 and 23 are not underlined.]

	Estimate of Change in Cash Flows	
	Hedging Instrument	Hedged Item Due to Fluctuation in Hedged Risk
Forward price of copper (dollars per pound)		
At hedge inception (Jan 15, 20X1)	\$ 2.10	\$ 2.10
At first subsequent assessment date (March 31, 20X1)	\$ 2.25	\$ 2.25
Change in forward price of copper	\$ 0.15	\$ 0.15
Cumulative change in copper (per pound) × 10,000 pounds of copper	\$ 1,500.00	\$ 1,500.00

815-30-55-141 Entity J could assess effectiveness as of March 31, 20X1, by comparing the \$1,500 change in the hedging instrument with the \$1,500 change in the hedged item attributable to changes in the hedged risk because the hedging instrument's maturity date and the date on which the price of copper will be fixed match (that is, July 1, 20X1).

> > Example 23: Designation of a Cash Flow Hedge of a Forecasted Purchase of Inventory for Which Commodity Exposure Is Managed Centrally

815-30-55-142 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to the designation of a **cash flow hedge** of a forecasted purchase of inventory in which the commodity exposure is managed centrally at the aggregate level. Assume the entity elects to perform subsequent assessments of hedge effectiveness on a qualitative basis and all hedge documentation requirements were satisfied at inception.

815-30-55-143 Entity Q is seeking to hedge the variability in cash flows associated with commodity price risk of its monthly plastic purchases for the next 12 months. It has two different manufacturing plant locations (Plant A and Plant B) that are purchasing five different grades of plastic from Supplier A. The plastic purchase price for each month is based on the month-end Joint Plastic (JP) index and a fixed basis differential component. The fixed basis differential offered by the supplier is determined by:

- a. The grade of the plastic purchased
- b. The distance between the plant location and supplier location.

815-30-55-144 At January 1, 20X1, Entity Q enters into a supply agreement with Supplier A to purchase plastic over the next 12 months. The respective agreements allow Entity Q to purchase the various grades of plastic at both of its plant locations as the need arises over the following year. The following table summarizes the pricing provisions contained in the supply agreement for each grade of plastic.

	<u>Grade 1</u>	<u>Grade 2</u>	<u>Grade 3</u>	<u>Grade 4</u>	<u>Grade 5</u>
Plant A	JP + \$0.14	JP + \$0.11	JP + \$0.09	JP + \$0.05	JP – \$0.02
Plant B	JP + \$0.16	JP + \$0.12	JP + \$0.07	JP + \$0.06	JP – \$0.03

815-30-55-145 Entity Q's risk management objective is to hedge the variability in the purchase price of plastic attributable to changes in the JP index of the first 80,000 pounds of plastic purchased in each month regardless of grade or plant location delivered to. To accomplish this objective, Entity Q executes 12 separate forward contracts at January 1, 20X1, to purchase plastic as follows.

	<u>Settlement Date</u>	<u>Notional Amount</u>	<u>Underlying Index</u>
Jan forward	January 30, 20X1	80,000 (lbs)	JP
Feb forward	February 28, 20X1	80,000 (lbs)	JP
Mar forward	March 30, 20X1	80,000 (lbs)	JP
April forward	April 30, 20X1	80,000 (lbs)	JP
May forward	May 30, 20X1	80,000 (lbs)	JP
June forward	June 30, 20X1	80,000 (lbs)	JP
July forward	July 30, 20X1	80,000 (lbs)	JP
Aug forward	August 30, 20X1	80,000 (lbs)	JP
Sep forward	September 30, 20X1	80,000 (lbs)	JP
Oct forward	October 30, 20X1	80,000 (lbs)	JP
Nov forward	November 30, 20X1	80,000 (lbs)	JP
Dec forward	December 30, 20X1	80,000 (lbs)	JP

815-30-55-146 Entity Q determines that the variable JP index referenced in the supply agreement constitutes a contractually specified component and that the requirements to designate variability in the cash flows attributable to changes in a contractually specified component as the hedged risk in paragraph 815-20-25-22A are met.

815-30-55-147 Because Entity Q determined that it will purchase at least 80,000 pounds of plastic each month in the coming 12 months to fulfill its expected manufacturing requirements, it documents that the hedged item (that is, the **forecasted transaction** within each month) is probable of occurring. Entity Q designates each forward contract as a cash flow hedge of the variability in cash flows attributable to changes in the contractually specified JP index on the first 80,000 pounds of plastic purchased (regardless of grade or plant location delivered to) for the appropriate month. The individual purchases of differing grades of plastic by Plant A and Plant B during each month share the risk exposure to the variability in the purchase price of the plastic attributable to changes in the contractually specified JP index. Therefore, the individual transactions in the hedged portfolio of plastic purchases for each month share the same risk exposure for which they are designated as being hedged in accordance with paragraph 815-20-25-15(a)(2).

815-30-55-148 In accordance with paragraph 815-20-25-3(b)(2)(iv)(01)(B), if Entity Q has determined the critical terms of the hedged item and hedging instrument match, it may elect to assess effectiveness qualitatively both at inception of the hedging relationship and on an ongoing basis on the basis of the following factors in accordance with paragraphs 815-20-25-84 through 25-85:

- The hedging instrument's underlying matches the index upon which plastic purchases will be determined (that is, the JP Index).
- The notional of the hedging instrument matches the forecasted quantity designated as the hedged item.
- The date on which the derivatives mature matches the timing in which the forecasted purchases are expected to be made. That is, the quantity of

- the hedged item, 80,000 pounds, is an aggregate amount expected to be purchased over the course of the respective month (that is, the same 31-day period) in which the derivative matures.
- d. Each hedging instrument was traded with at-market terms (that is, it has an initial fair value of zero).
 - e. Assessment of effectiveness will be performed on the basis of the total change in the fair value of the hedging instrument.
 - f. Although the amount of plastic being hedged each period is a cumulative amount across multiple grades of plastic, the basis differentials between grades of plastic and location are not required to be included in assessments of effectiveness because Entity Q has designated the variability in cash flows attributable to changes in the JP index (the contractually specified component) as the hedged risk within its purchases of plastics.

Amendments to Subtopic 815-35

25. Amend paragraph 815-35-05-1, with a link to transition paragraph 815-20-65-3, as follows:

Derivatives and Hedging—Net Investment Hedges

Overview and Background

815-35-05-1 This Subtopic provides incremental guidance on accounting for and financial reporting of hedges of a net investment in a foreign operation established under the criteria in Subtopic 815-20, such as subsequent measurement and dedesignation of a hedging relationship.

Scope and Scope Exceptions

> Overall Guidance

815-35-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in Subtopic 815-20, see Section 815-20-15.

Recognition

815-35-25-1 See Section 815-20-25 for the criteria under which an entity may designate a net investment hedge.

26. Amend paragraphs 815-35-35-1, 815-35-35-3 through 35-5 and the related heading, 815-35-35-7, 815-35-35-9 through 35-14, 815-35-35-17 through 35-21,

and 815-35-35-26, add paragraphs 815-35-35-4A, 815-35-35-5A through 55-5B, and 815-35-35-17A and its related heading, and supersede paragraphs 815-35-35-15 through 35-16 and 815-35-35-22 through 35-25, with a link to transition paragraph 815-20-65-3, as follows:

Subsequent Measurement

> Overall

815-35-35-1 The gain or loss on a hedging **derivative instrument** (or the foreign currency transaction gain or loss on the nonderivative hedging instrument) that is designated as, and is effective as, an economic hedge of the net investment in a foreign operation shall be reported in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of **other comprehensive income**) ~~to the extent it is effective as a hedge.~~

815-35-35-2 The hedged net investment shall be accounted for consistent with Topic 830. The provisions of Subtopic 815-25 for recognizing the gain or loss on assets designated as being hedged in a **fair value hedge** do not apply to the hedge of a net investment in a foreign operation.

815-35-35-3 If an entity has designated and documented that it will assess measure effectiveness and measure hedge results on an after-tax basis as permitted by paragraph 815-20-25-3(b)(2)(vi), the portion of the gain or loss on the hedging instrument that exceeded the loss or gain on the hedged item shall be included as an offset to the related tax effects in the period in which those tax effects are recognized.

> Measuring Assessing Hedge Effectiveness and Measuring Hedge Results Ineffectiveness

815-35-35-4 If a derivative instrument is used as the hedging instrument, an entity may assess the effectiveness of ~~measure the amount of ineffectiveness in~~ a net investment hedge using either a method based on changes in spot exchange rates (as specified in paragraphs 815-35-35-5 through 35-15) or a method based on changes in forward exchange rates (as specified in paragraphs ~~815-35-35-16~~ 815-35-35-17 through 35-26). This guidance can also be applied to purchased options used as hedging instruments in a net investment hedge. However, an entity shall consistently use the same method for all its net investment hedges in which the hedging instrument is a derivative instrument; use of the spot method for some net investment hedges and the forward method for other net investment hedges is not permitted. An entity may change the method that it chooses to assess the effectiveness of its net investment hedges in accordance with paragraphs 815-20-55-55 through 55-56A.

815-35-35-4A Hedge effectiveness shall be assessed on a quantitative basis at hedge inception in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) unless one of the exceptions in that paragraph applies. Subsequent assessments of hedge effectiveness may be performed either on a quantitative basis or on a qualitative basis in accordance with paragraphs 815-20-35-2 through 35-2F.

> > Method Based on Changes in Spot Exchange Rates

> > > Hedging Instrument Is a Derivative Instrument

815-35-35-5 The change in the **fair value** of the derivative instrument attributable to changes in the difference between the forward rate and **spot rate** would be excluded from the ~~measure~~ assessment of hedge effectiveness ~~ineffectiveness~~ and that difference would be reported directly in earnings if all of the following conditions are met:

- a. The **notional amount** of the derivative instrument designated as a hedge of a net investment in a foreign operation matches (that is, equals) the portion of the net investment designated as being hedged.
- b. The derivative instrument's underlying exchange rate is the exchange rate between the functional currency of the hedged net investment and the investor's functional currency.
- c. ~~The~~ When the hedging derivative instrument is a cross-currency interest rate swap, it is eligible for designation in a net investment hedge ~~as permitted by~~ in accordance with paragraph 815-20-25-67.

In that circumstance, the hedging relationship would be considered perfectly effective, and no quantitative effectiveness assessment is required at hedge inception. (See paragraph 815-20-25-3(b)(2)(iv)(01).)

815-35-35-5A An entity shall recognize in earnings the initial value of the component excluded from the assessment of effectiveness using a systematic and rational method over the life of the hedging instrument. Any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method shall be recognized in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of other comprehensive income).

815-35-35-5B An entity alternatively may elect to record changes in the fair value of the excluded component currently in earnings. This election shall be applied consistently to similar hedges in accordance with paragraph 815-20-25-81.

815-35-35-6 The interest accrual (periodic cash settlement) components of qualifying receive-variable-rate, pay-variable-rate and receive-fixed rate, pay-

fixed-rate cross-currency interest rate swaps shall also be reported directly in earnings.

815-35-35-7 ~~The effective portion of the change in fair value of the derivative instrument attributable to changes in the spot rate shall be reported in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of other comprehensive income). The effective portion that would be reported in the cumulative translation adjustment section of other comprehensive income shall be determined by looking to changes in spot exchange rates.~~

815-35-35-8 The spot-to-spot changes in value reported in the cumulative translation adjustment section of other comprehensive income shall not be discounted.

815-35-35-9 ~~The hedging relationship would not be considered perfectly effective, and the guidance in the following paragraph 815-35-35-10 shall be applied if any of the following conditions exist:~~

- a. The notional amount of the derivative instrument does not match the portion of the net investment designated as being hedged.
- b. The derivative instrument's underlying exchange rate is not the exchange rate between the functional currency of the hedged net investment and the investor's functional currency.
- c. ~~When the~~ The hedging derivative instrument is a cross-currency interest rate swap ~~as permitted by~~ eligible for designation in a net investment hedge in accordance with paragraph 815-20-25-67, 815-20-25-67 in which both legs are not based on comparable interest rate curves (for example, pay foreign currency based on the three-month London Interbank Offered Rate [LIBOR], receive functional currency based on three-month commercial paper rates).

815-35-35-10 ~~If any of the conditions in the preceding paragraph 815-35-35-9 exist, the effective portion that would be reported in the cumulative translation adjustment section of other comprehensive income of a the change in fair value of the hypothetical derivative instrument that does not incorporate those differences shall be compared with to the change in fair value of the actual derivative instrument in assessing hedge effectiveness to determine the hedging ineffectiveness. Any difference shall be recognized in earnings.~~

815-35-35-11 The hypothetical derivative instrument used to assess hedge effectiveness also shall ~~also~~ have a maturity and repricing and payment frequencies for any interim payments that match the maturity and repricing and payment frequencies for any interim payments of the actual derivative instrument designated as the hedging instrument in the net investment hedge.

> > > Hedging Instrument Is Not a Derivative Instrument

815-35-35-12 The translation gain or loss determined under Subtopic 830-30 by reference to the spot exchange rate between the transaction currency of the debt and the functional currency of the investor (after tax effects, if appropriate) shall be reported in the same manner as the translation adjustment associated with the hedged net investment (that is, reported in the cumulative translation adjustment section of other comprehensive income) if both of the following conditions are met:

- a. The notional amount of the nonderivative instrument matches the portion of the net investment designated as being hedged.
- b. The nonderivative instrument is denominated in the functional currency of the hedged net investment.

In that circumstance, the hedging relationship would be considered perfectly effective, and no prospective quantitative effectiveness assessment is required at hedge inception (see paragraph 815-20-25-3(b)(2)(iv)(01)). ~~no hedge ineffectiveness would be recognized in earnings.~~

815-35-35-13 ~~Recognition of hedge ineffectiveness in earnings is required~~ The hedging relationship would not be perfectly effective if either of the following conditions is met:

- a. The notional amount of the nonderivative instrument does not match the portion of the net investment designated as being hedged.
- b. The nonderivative instrument is denominated in a currency other than the functional currency of the hedged net investment.

815-35-35-14 ~~Ineffectiveness~~ Effectiveness shall be assessed ~~recognized in earnings~~ by comparing the following two values:

- a. The foreign currency transaction gain or loss based on the spot rate change (after tax effects, if appropriate) of that nonderivative instrument
- b. The transaction gain or loss based on the spot rate change (after tax effects, if appropriate) that would result from the appropriate hypothetical nonderivative instrument that does not incorporate those differences. The hypothetical nonderivative instrument shall also have a maturity that matches the maturity of the actual nonderivative instrument designated as the net investment hedge.

815-35-35-15 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~Any difference between the spot rate change of the hypothetical nonderivative instrument and the actual hedging nonderivative instrument shall be recognized in earnings. That is, ineffectiveness shall be recognized in earnings for both overhedges and underhedges.~~

> > Method Based on Changes in Forward Exchange Rates

815-35-35-16 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~If the notional amount of the derivative instrument designated as a hedge of a net investment in a foreign operation matches (that is, equals) the portion of the net investment designated as being hedged and the derivative instrument's underlying relates solely to the foreign exchange rate between the functional currency of the hedged net investment and the investor's functional currency, all changes in fair value of the derivative instrument shall be reported in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of other comprehensive income). [Content amended and moved to paragraph 815-35-35-17A]~~

815-35-35-17 ~~In that circumstance, no hedge ineffectiveness would be recognized in earnings for either of the following Under a method based on changes in forward exchange rates, an entity shall report all changes in fair value of the derivative instrument in the same manner as a translation adjustment (that is, reported in the cumulative translation adjustment section of other comprehensive income), including the following amounts:~~

- a. The time value component of purchased options
- b. The interest accrual/periodic cash settlement components of qualifying receive-variable-rate, pay-variable-rate and receive-fixed-rate, pay-fixed-rate cross-currency interest rate swaps.

> > > Assessment of Effectiveness

815-35-35-17A ~~If the notional amount of the derivative instrument designated as a hedge of a net investment in a foreign operation matches (that is, equals) the portion of the net investment designated as being hedged and the derivative instrument's underlying relates solely to the foreign exchange rate between the functional currency of the hedged net investment and the investor's functional currency, the hedging relationship would be considered perfectly effective, and no quantitative effectiveness assessment is required at hedge inception (see paragraph 815-20-25-3(b)(2)(iv)(01)). all changes in fair value of the derivative instrument shall be reported in the same manner as a translation adjustment (that is, reported in the cumulative adjustment section of other comprehensive income). [Content amended as shown and moved from paragraph 815-35-35-16]~~

815-35-35-18 ~~However, the hedging relationship would not be considered perfectly effective recognition of hedge ineffectiveness in earnings is required if any of the following conditions exist:~~

- a. The notional amount of the derivative instrument does not match the portion of the net investment designated as being hedged.

- b. The derivative instrument's underlying exchange rate is not the exchange rate between the functional currency of the hedged net investment and the investor's functional currency.
- c. ~~The~~ When the hedging derivative instrument is a cross-currency interest rate swap ~~meeting the criteria of~~ eligible for designation in a net investment hedge in accordance with paragraph 815-20-25-67, 815-20-25-67 in which both legs are not based on comparable interest rate curves (for example, pay foreign currency based on three-month LIBOR, receive functional currency based on three-month commercial paper rates).

815-35-35-19 The assessment measurement of hedge effectiveness ineffectiveness due to such differences between the hedging derivative instrument and the hedged net investment considers the following is as follows:

- a. Different notional amounts. If the notional amount of the derivative instrument designated as a hedge of the net investment does not match the portion of the net investment designated as being hedged, ~~the amount of hedge effectiveness ineffectiveness required to be recognized in earnings~~ shall be assessed measured by comparing the following two values:
 - 1. The change in fair value of the actual derivative instrument designated as the hedging instrument
 - 2. The change in fair value of a hypothetical derivative instrument that has a notional amount that matches the portion of the net investment being hedged and a maturity that matches the maturity of the actual derivative instrument designated as the net investment hedge. See paragraph 815-35-35-26 for situations in which the hedge of a net investment in a foreign operation is hedging foreign currency risk on an after-tax basis, as permitted by paragraph 815-20-25-3(b)(2)(vi).
- b. Different currencies. If the derivative instrument designated as the hedging instrument has an underlying foreign exchange rate that is not the exchange rate between the functional currency of the hedged net investment and the investor's functional currency (a tandem currency hedge), ~~the amount of hedge effectiveness ineffectiveness required to be recognized in earnings~~ shall be assessed measured by comparing the following two values:
 - 1. The change in fair value of the actual cross-currency hedging instrument
 - 2. The change in fair value of a hypothetical derivative instrument that has as its underlying the foreign exchange rate between the functional currency of the hedged net investment and the investor's functional currency and a maturity and repricing and payment frequencies for any interim payments that match the maturity and repricing and payment frequencies for any interim payments of the actual derivative instrument designated as the net investment hedge.

- c. Multiple underlyings. In accordance with paragraph 815-20-25-67(a), the only derivative instruments with multiple underlyings permitted to be designated as a hedge of a net investment are receive-variable-rate, pay-variable-rate cross-currency interest rate swaps that meet certain criteria. Paragraph 815-20-25-67(b) also permits receive-fixed-rate, pay-fixed-rate cross-currency interest rate swaps to be designated as a hedge of a net investment.

815-35-35-20 If a receive-variable-rate, pay-variable-rate cross-currency interest rate swap is designated as the hedging instrument in a net investment hedge, ~~the amount of hedge effectiveness ineffectiveness required to be recognized in earnings~~ shall be assessed ~~measured~~ by comparing the following two values:

- a. The change in fair value of the actual cross-currency interest rate swap designated as the hedging instrument
- b. The change in fair value of a hypothetical receive-variable-rate, pay-variable-rate cross-currency interest rate swap in which the interest rates are based on the same currencies contained in the hypothetical swap and both legs of the hypothetical swap have the same repricing intervals and dates. The hypothetical derivative instrument also shall have a maturity that matches the maturity of the actual cross-currency interest rate swap designated as the net investment hedge.

815-35-35-21 If a receive-fixed-rate, pay-fixed-rate cross-currency interest rate swap is designated as the hedging instrument in a net investment hedge, ~~the amount of hedge effectiveness ineffectiveness required to be recognized in earnings~~ shall be assessed ~~measured~~ by comparing the following two values:

- a. The change in fair value of the actual cross-currency interest rate swap designated as the hedging instrument
- b. The change in fair value of a hypothetical receive-fixed-rate, pay-fixed-rate cross-currency interest rate swap in which the interest rates are based on the same currencies contained in the hypothetical swap. The hypothetical derivative instrument shall also have a maturity that matches the maturity of the actual cross-currency interest rate swap designated as the net investment hedge.

815-35-35-22 ~~Paragraph superseded by Accounting Standards Update No. 2017-12. If any such differences exist between the hedging derivative instrument and the hedged net investment, changes in value of the hypothetical derivative instrument shall be recorded in the cumulative translation adjustment section of other comprehensive income. Any difference between the change in fair value of the hypothetical derivative instrument and the actual hedging derivative instrument shall be recognized in earnings.~~

815-35-35-23 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~Ineffectiveness in a net investment hedge shall be recognized in earnings for both overhedges and underhedges—specifically:~~

- ~~a. If the change in the fair value of the actual derivative instrument designated as the hedging instrument exceeds the change in fair value of the hypothetical derivative instrument, the difference represents an overhedge that shall be recognized in earnings.~~
- ~~b. If the change in fair value of the actual derivative instrument designated as the hedging instrument is smaller than the change in fair value of the hypothetical derivative instrument, the difference represents an underhedge that shall be recognized in earnings.~~

815-35-35-24 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~The recognition of hedge ineffectiveness for an underhedge of an entity's net investment in a foreign operation deliberately differs from the accounting for cash flow hedges in Subtopic 815-30.~~

815-35-35-25 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~If ineffectiveness must be recognized in earnings because the hedging instrument involves multiple differences (that is, different notional amounts, currencies, and underlyings), the amount of ineffectiveness can be determined by a single comparison to the appropriate hypothetical derivative instrument that does not incorporate those differences.~~

815-35-35-26 Paragraph 815-20-25-3(b)(2)(vi) permits hedging foreign currency risk on an after-tax basis, provided that the documentation of the hedge at its inception indicated that the assessment of effectiveness and measurement of hedge results, including the calculation of ineffectiveness, will be on an after-tax basis (rather than on a pretax basis). If an entity has elected to hedge foreign currency risk on an after-tax basis, it shall adjust the notional amount of its derivative instrument appropriately to reflect the effect of tax rates. In that case, the hypothetical derivative instrument used to ~~assess effectiveness~~ measure ineffectiveness shall have a notional amount that has been appropriately adjusted (pursuant to the documentation at inception) to reflect the effect of the after-tax approach.

> Redesignation

815-35-35-27 If an entity documents that the effectiveness of its hedge of the net investment in a foreign operation will be assessed based on the beginning balance of its net investment and the entity's net investment changes during the year, the entity shall consider the need to redesignate the hedging relationship (to indicate what the hedging instrument is and what numerical portion of the current net investment is the hedged portion) whenever financial statements or earnings are

reported, and at least every three months. An entity is not required to redesignate the hedging relationship more frequently even when a significant transaction (for example, a dividend) occurs during the interim period. Example 1 (see paragraph 815-35-55-1) illustrates the application of this guidance.

27. Add Section 815-35-40, with a link to transition paragraph 815-20-65-3, as follows:

Derecognition

> Discontinuing Hedge Accounting

> > Amounts Excluded from the Assessment of Effectiveness under an Amortization Approach

815-35-40-1 When applying the guidance in paragraph 815-35-35-5A and a hedge is discontinued, any amounts that have not yet been recognized in earnings shall remain in the cumulative translation adjustment section of accumulated other comprehensive income until the hedged net investment is sold or liquidated in accordance with paragraphs 830-30-40-1 through 40-1A.

28. Supersede paragraph 815-35-50-2, with a link to transition paragraph 815-20-65-3, as follows:

Disclosure

815-35-50-1 Paragraph not used.

815-35-50-2 Paragraph superseded by Accounting Standards Update No. 2017-12. ~~For guidance on qualitative disclosures, see paragraph 815-10-50-5. The quantitative disclosures about derivative instruments may be more useful, and less likely to be perceived to be out of context or otherwise misunderstood, if similar information is disclosed about other financial instruments or nonfinancial assets and liabilities to which the derivative instruments are related by activity. Accordingly, in those situations, an entity is encouraged, but not required, to present a more complete picture of its activities by disclosing that information. [Content amended and moved to paragraph 815-10-50-5A]~~

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Frequency of Designation of Hedged Net Investment

815-35-55-1 This Example illustrates the application of paragraph 815-35-35-27. Assume that an entity enters into a foreign currency forward contract that has a **notional amount** equal to the beginning balance of its investment in a foreign operation (for example, 100,000 foreign currency units [FC]). This foreign currency forward contract is immediately designated as a hedge of the entire beginning balance of the net investment at the inception of the hedge. As the net investment changes, the entity would periodically assess the original hedging relationship and decide whether it needs to remove (that is, dedesignate) that original relationship and designate a new hedging relationship for the following assessment period. The following presents one method of such redesignation in those circumstances in which the entity chooses not to obtain a new **derivative instrument**:

- a. If the net investment had increased (for example, to FC 120,000), the entire forward contract would be designated prospectively as hedging only a portion of the beginning balance of the net investment in that foreign operation. The hedged portion would be the ratio of the net investment at the inception of the hedge to the net investment at the beginning of the new assessment period (for example, five-sixths of the FC 120,000).
- b. If the net investment had decreased (for example, to FC 90,000), only a proportion of the forward contract would be designated prospectively as hedging the entire beginning balance of the net investment in that foreign operation. The proportion of the forward contract designated prospectively as the hedging instrument would be the ratio of the net investment at the beginning of the new assessment period to the net investment at the inception of the hedge (for example, nine-tenths of the forward contract). The proportion of the forward contract not designated prospectively as the hedging instrument in the net investment hedge could be designated as a hedging instrument in a different hedging relationship or simply reported at **fair value** with its gain or loss after the dedesignation date recognized currently in earnings pursuant to paragraph 815-20-35-1(a).

[The following paragraph is shown for context.]

Financial Services—Depository and Lending

Investments—Debt and Equity Securities

Disclosure

942-320-50-1 For purposes of the disclosure requirements of paragraphs 320-10-50-1 through 50-3 and 320-10-50-5, the term *financial institutions* includes banks, savings and loan associations, savings banks, credit unions, finance companies, and insurance entities.

Amendments to Subtopic 954-225

29. Amend paragraph 954-225-45-7, with a link to transition paragraph 815-20-65-3, as follows:

Health Care Entities—Income Statement

Other Presentation Matters

954-225-45-7 Health care entities shall report the following items separately from the performance indicator:

- a. Transactions with owners acting in that capacity.
- b. Equity transfers involving other entities that control the reporting entity, are controlled by the reporting entity, or are under common control with the reporting entity.
- c. Receipt of donor-restricted **contributions**.
- d. Contributions of, and assets released from donor restrictions related to, long-lived assets.
- e. Items that are required to be reported in or reclassified from other comprehensive income in accordance with paragraph 220-10-45-10A, which includes, but is not limited to, gains or losses, prior service costs or credits, and transition assets or obligations recognized in accordance with Topic 715; foreign currency translation adjustments; ~~and the effective~~ portion of the gain or loss on derivative instruments designated and qualifying as cash flow hedging instruments included in the assessment of effectiveness, and for all qualifying hedging relationships amounts excluded from the assessment of effectiveness and recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A.
- f. Items that are required to be reported separately under specialized not-for-profit standards.
- g. Unrealized gains and losses on investments on other than trading debt securities, in accordance with paragraph 954-225-45-8.
- h. Investment returns restricted by donors or by law.
- i. Subparagraph superseded by Accounting Standards Update No. 2016-

- j. Subparagraph superseded by Accounting Standards Update No. 2016-14.
- k. An **inherent contribution** (see paragraph 958-805-25-31) that increases **net assets with donor restrictions**, as described in paragraph 954-805-45-2.
- l. The portion of the total change in the fair value of the liability resulting from a change in the instrument-specific credit risk, in accordance with paragraph 825-10-45-5.

Amendments to Subtopic 954-815

30. Amend paragraph 954-815-45-1, with a link to transition paragraph 815-20 65-3, as follows:

Health Care Entities—Derivatives and Hedging

Other Presentation Matters

954-815-45-1 The absence of a requirement to report a separate component of equity in the balance sheet of a not-for-profit, business-oriented health care entity shall not preclude those entities from using comprehensive income reporting for qualifying gains and losses on cash flow and fair value hedges. For a fair value hedge, amounts may be recorded in other comprehensive income if amounts are excluded from the assessment of effectiveness and are recognized in earnings through an amortization approach in accordance with paragraph 815-20-25-83A. Although accumulated other comprehensive income will inherently be carried forward in a not-for-profit health care entity's net assets, there is no compelling need for it to be reported separately in the balance sheet.

Amendments to Status Sections

31. Amend paragraph 220-10-00-1, by adding the following item to the table, as follows:

220-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
220-10-45-10A	Amended	2017-12	08/28/2017

32. Amend paragraph 320-10-00-1, by adding the following items to the table, as follows:

320-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
320-10-35-1	Amended	2017-12	08/28/2017
320-10-45-8	Amended	2017-12	08/28/2017

33. Amend paragraph 815-10-00-1, by adding the following items to the table, as follows:

815-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Benchmark Interest Rate	Added	2017-12	08/28/2017
Credit Risk	Amended	2017-12	08/28/2017
Interest Rate Risk	Amended	2017-12	08/28/2017
815-10-50-1B	Amended	2017-12	08/28/2017
815-10-50-3	Amended	2017-12	08/28/2017
815-10-50-4A	Amended	2017-12	08/28/2017
815-10-50-4C	Amended	2017-12	08/28/2017
815-10-50-4CC	Added	2017-12	08/28/2017
815-10-50-4CCC	Added	2017-12	08/28/2017
815-10-50-4D	Amended	2017-12	08/28/2017
815-10-50-4E	Amended	2017-12	08/28/2017
815-10-50-4EE through 50-4EEEE	Added	2017-12	08/28/2017
815-10-50-4F	Amended	2017-12	08/28/2017
815-10-50-5A	Added	2017-12	08/28/2017
815-10-50-5B	Added	2017-12	08/28/2017
815-10-55-181	Amended	2017-12	08/28/2017
815-10-55-182	Amended	2017-12	08/28/2017

34. Amend paragraph 815-15-00-1, by adding the following items to the table, as follows:

815-15-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Benchmark Interest Rate	Added	2017-12	08/28/2017
Credit Risk	Amended	2017-12	08/28/2017
Interest Rate Risk	Amended	2017-12	08/28/2017

35. Amend paragraph 815-20-00-1, by adding the following items to the table, as follows:

815-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Auction Rate Notes	Amended	2017-12	08/28/2017
Contractually Specified Component	Added	2017-12	08/28/2017
Credit Risk	Amended	2017-12	08/28/2017
Interest Rate Risk	Amended	2017-12	08/28/2017
Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate	Added	2017-12	08/28/2017
815-20-05-1	Amended	2017-12	08/28/2017
815-20-05-2	Amended	2017-12	08/28/2017
815-20-05-3 through 05-10	Superseded	2017-12	08/28/2017
815-20-25-1	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-20-25-3	Amended	2017-12	08/28/2017
815-20-25-3A	Added	2017-12	08/28/2017
815-20-25-6	Amended	2017-12	08/28/2017
815-20-25-6A	Amended	2017-12	08/28/2017
815-20-25-6B	Added	2017-12	08/28/2017
815-20-25-12	Amended	2017-12	08/28/2017
815-20-25-12A	Added	2017-12	08/28/2017
815-20-25-15	Amended	2017-12	08/28/2017
815-20-25-16	Amended	2017-12	08/28/2017
815-20-25-17	Amended	2017-12	08/28/2017
815-20-25-19	Amended	2017-12	08/28/2017
815-20-25-19A	Added	2017-12	08/28/2017
815-20-25-19B	Added	2017-12	08/28/2017
815-20-25-22A	Added	2017-12	08/28/2017
815-20-25-22B	Added	2017-12	08/28/2017
815-20-25-36	Amended	2017-12	08/28/2017
815-20-25-43	Amended	2017-12	08/28/2017
815-20-25-46B	Amended	2017-12	08/28/2017
815-20-25-50	Amended	2017-12	08/28/2017
815-20-25-51	Amended	2017-12	08/28/2017
815-20-25-54	Amended	2017-12	08/28/2017
815-20-25-72	Amended	2017-12	08/28/2017
815-20-25-73	Amended	2017-12	08/28/2017
815-20-25-77	Amended	2017-12	08/28/2017
815-20-25-79 through 25-86	Amended	2017-12	08/28/2017
815-20-25-79A	Added	2017-12	08/28/2017
815-20-25-83A	Added	2017-12	08/28/2017
815-20-25-83B	Added	2017-12	08/28/2017
815-20-25-84A	Added	2017-12	08/28/2017
815-20-25-102	Amended	2017-12	08/28/2017
815-20-25-104 through 25-106	Amended	2017-12	08/28/2017
815-20-25-111	Amended	2017-12	08/28/2017
815-20-25-113	Amended	2017-12	08/28/2017
815-20-25-117	Amended	2017-12	08/28/2017
815-20-25-117A through 25-117D	Added	2017-12	08/28/2017
815-20-25-118	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-20-25-118A	Added	2017-12	08/28/2017
815-20-25-119	Amended	2017-12	08/28/2017
815-20-25-125	Amended	2017-12	08/28/2017
815-20-25-129	Amended	2017-12	08/28/2017
815-20-25-129A	Added	2017-12	08/28/2017
815-20-25-131AA through 25-132	Superseded	2017-12	08/28/2017
815-20-25-133 through 25-143	Added	2017-12	08/28/2017
815-20-35-1	Amended	2017-12	08/28/2017
815-20-35-2	Amended	2017-12	08/28/2017
815-20-35-2A through 35-2G	Added	2017-12	08/28/2017
815-20-35-7	Superseded	2017-12	08/28/2017
815-20-35-8	Amended	2017-12	08/28/2017
815-20-35-9	Amended	2017-12	08/28/2017
815-20-35-11	Amended	2017-12	08/28/2017
815-20-35-12	Amended	2017-12	08/28/2017
815-20-35-13	Superseded	2017-12	08/28/2017
815-20-35-16	Amended	2017-12	08/28/2017
815-20-35-17	Superseded	2017-12	08/28/2017
815-20-35-19	Amended	2017-12	08/28/2017
815-20-45-1	Superseded	2017-12	08/28/2017
815-20-45-1A through 45-1D	Added	2017-12	08/28/2017
815-20-45-3	Added	2017-12	08/28/2017
815-20-55-2	Amended	2017-12	08/28/2017
815-20-55-4A	Amended	2017-12	08/28/2017
815-20-55-5 through 55-8	Superseded	2017-12	08/28/2017
815-20-55-11	Amended	2017-12	08/28/2017
815-20-55-12	Amended	2017-12	08/28/2017
815-20-55-14A	Added	2017-12	08/28/2017
815-20-55-15	Amended	2017-12	08/28/2017
815-20-55-17	Amended	2017-12	08/28/2017
815-20-55-19	Amended	2017-12	08/28/2017
815-20-55-23	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-20-55-26A through 55-26E	Added	2017-12	08/28/2017
815-20-55-27 through 55-32	Amended	2017-12	08/28/2017
815-20-55-33A	Amended	2017-12	08/28/2017
815-20-55-33B	Amended	2017-12	08/28/2017
815-20-55-33C	Superseded	2017-12	08/28/2017
815-20-55-33D	Superseded	2017-12	08/28/2017
815-20-55-33E	Amended	2017-12	08/28/2017
815-20-55-33F	Superseded	2017-12	08/28/2017
815-20-55-39	Superseded	2017-12	08/28/2017
815-20-55-40	Amended	2017-12	08/28/2017
815-20-55-41 through 55-43	Superseded	2017-12	08/28/2017
815-20-55-44C	Amended	2017-12	08/28/2017
815-20-55-46	Amended	2017-12	08/28/2017
815-20-55-54 through 55-56	Amended	2017-12	08/28/2017
815-20-55-62	Amended	2017-12	08/28/2017
815-20-55-62A	Added	2017-12	08/28/2017
815-20-55-64	Amended	2017-12	08/28/2017
815-20-55-68	Amended	2017-12	08/28/2017
815-20-55-69	Amended	2017-12	08/28/2017
815-20-55-71	Amended	2017-12	08/28/2017
815-20-55-75	Amended	2017-12	08/28/2017
815-20-55-79A	Amended	2017-12	08/28/2017
815-20-55-79B	Amended	2017-12	08/28/2017
815-20-55-79C through 55-79AD	Added	2017-12	08/28/2017
815-20-55-80A	Added	2017-12	08/28/2017
815-20-55-86	Amended	2017-12	08/28/2017
815-20-55-90	Amended	2017-12	08/28/2017
815-20-55-94	Amended	2017-12	08/28/2017
815-20-55-96	Amended	2017-12	08/28/2017
815-20-55-98	Amended	2017-12	08/28/2017
815-20-55-99	Amended	2017-12	08/28/2017
815-20-55-103 through 55-105	Amended	2017-12	08/28/2017
815-20-55-107 through 55-110	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-20-55-126	Amended	2017-12	08/28/2017
815-20-55-129	Amended	2017-12	08/28/2017
815-20-55-131	Amended	2017-12	08/28/2017
815-20-55-135	Amended	2017-12	08/28/2017
815-20-55-149	Amended	2017-12	08/28/2017
815-20-55-155	Amended	2017-12	08/28/2017
815-20-55-175	Amended	2017-12	08/28/2017
815-20-55-178	Amended	2017-12	08/28/2017
815-20-55-197	Amended	2017-12	08/28/2017
815-20-55-199	Amended	2017-12	08/28/2017
815-20-55-204	Amended	2017-12	08/28/2017
815-20-55-211	Amended	2017-12	08/28/2017
815-20-55-226 through 55-229	Superseded	2017-12	08/28/2017
815-20-55-230 through 55-238	Added	2017-12	08/28/2017
815-20-65-3	Added	2017-12	08/28/2017

36. Amend paragraph 815-25-00-1, by adding the following items to the table, as follows:

815-25-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Interest Rate Risk	Amended	2017-12	08/28/2017
815-25-05-1	Amended	2017-12	08/28/2017
815-25-35-1	Amended	2017-12	08/28/2017
815-25-35-2	Superseded	2017-12	08/28/2017
815-25-35-3	Superseded	2017-12	08/28/2017
815-25-35-4	Amended	2017-12	08/28/2017
815-25-35-5	Superseded	2017-12	08/28/2017
815-25-35-7	Amended	2017-12	08/28/2017
815-25-35-7A	Added	2017-12	08/28/2017
815-25-35-9A	Added	2017-12	08/28/2017
815-25-35-11 through 35-14	Amended	2017-12	08/28/2017
815-25-35-13A	Added	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-25-35-13B	Added	2017-12	08/28/2017
815-25-35-19	Amended	2017-12	08/28/2017
815-25-40-2	Amended	2017-12	08/28/2017
815-25-40-7 through 40-9	Added	2017-12	08/28/2017
815-25-50-1	Amended	2017-12	08/28/2017
815-25-55-1	Amended	2017-12	08/28/2017
815-25-55-4	Amended	2017-12	08/28/2017
815-25-55-6 through 55-8	Amended	2017-12	08/28/2017
815-25-55-10 through 55-13	Amended	2017-12	08/28/2017
815-25-55-17	Amended	2017-12	08/28/2017
815-25-55-23	Amended	2017-12	08/28/2017
815-25-55-26	Amended	2017-12	08/28/2017
815-25-55-27	Amended	2017-12	08/28/2017
815-25-55-29 through 55-31	Amended	2017-12	08/28/2017
815-25-55-34 through 55-36	Amended	2017-12	08/28/2017
815-25-55-38	Amended	2017-12	08/28/2017
815-25-55-39	Amended	2017-12	08/28/2017
815-25-55-42	Amended	2017-12	08/28/2017
815-25-55-43	Amended	2017-12	08/28/2017
815-25-55-46	Amended	2017-12	08/28/2017
815-25-55-49	Amended	2017-12	08/28/2017
815-25-55-51	Amended	2017-12	08/28/2017
815-25-55-52	Amended	2017-12	08/28/2017
815-25-55-55 through 55-58	Amended	2017-12	08/28/2017
815-25-55-56A	Added	2017-12	08/28/2017
815-25-55-56B	Added	2017-12	08/28/2017
815-25-55-61	Amended	2017-12	08/28/2017
815-25-55-61A through 55-61C	Added	2017-12	08/28/2017
815-25-55-62 through 55-68	Amended	2017-12	08/28/2017
815-25-55-71	Amended	2017-12	08/28/2017
815-25-55-72	Amended	2017-12	08/28/2017
815-25-55-74 through 55-77	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-25-55-78 through 55-83	Superseded	2017-12	08/28/2017
815-25-55-85 through 55-87	Amended	2017-12	08/28/2017
815-25-55-88A	Added	2017-12	08/28/2017
815-25-55-89	Amended	2017-12	08/28/2017
815-25-55-91 through 55-108	Added	2017-12	08/28/2017

37. Amend paragraph 815-30-00-1, by adding the following items to the table, as follows:

815-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contractually Specified Component	Added	2017-12	08/28/2017
Credit Risk	Amended	2017-12	08/28/2017
Interest Rate Risk	Amended	2017-12	08/28/2017
815-30-05-1	Amended	2017-12	08/28/2017
815-30-35-1	Amended	2017-12	08/28/2017
815-30-35-2	Superseded	2017-12	08/28/2017
815-30-35-3	Amended	2017-12	08/28/2017
815-30-35-4	Superseded	2017-12	08/28/2017
815-30-35-5	Amended	2017-12	08/28/2017
815-30-35-7 through 35-14	Amended	2017-12	08/28/2017
815-30-35-15A	Added	2017-12	08/28/2017
815-30-35-16	Amended	2017-12	08/28/2017
815-30-35-19	Amended	2017-12	08/28/2017
815-30-35-21	Superseded	2017-12	08/28/2017
815-30-35-22	Amended	2017-12	08/28/2017
815-30-35-23	Amended	2017-12	08/28/2017
815-30-35-25 through 35-27	Amended	2017-12	08/28/2017
815-30-35-28	Superseded	2017-12	08/28/2017
815-30-35-29	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-30-35-30	Superseded	2017-12	08/28/2017
815-30-35-31	Amended	2017-12	08/28/2017
815-30-35-33	Amended	2017-12	08/28/2017
815-30-35-34	Amended	2017-12	08/28/2017
815-30-35-35 through 35-37	Superseded	2017-12	08/28/2017
815-30-35-37A	Added	2017-12	08/28/2017
815-30-35-38	Amended	2017-12	08/28/2017
815-30-35-39	Amended	2017-12	08/28/2017
815-30-35-41	Amended	2017-12	08/28/2017
815-30-35-41A through 35-41C	Added	2017-12	08/28/2017
815-30-40-2	Amended	2017-12	08/28/2017
815-30-40-5	Amended	2017-12	08/28/2017
815-30-40-6A	Added	2017-12	08/28/2017
815-30-45-1 through 45-3	Superseded	2017-12	08/28/2017
815-30-50-1	Amended	2017-12	08/28/2017
815-30-50-2	Amended	2017-12	08/28/2017
815-30-50-4	Amended	2017-12	08/28/2017
815-30-50-5	Added	2017-12	08/28/2017
815-30-50-6	Added	2017-12	08/28/2017
815-30-55-1 through 55-4	Amended	2017-12	08/28/2017
815-30-55-8 through 55-11	Amended	2017-12	08/28/2017
815-30-55-13 through 55-16	Amended	2017-12	08/28/2017
815-30-55-20 through 55-22	Amended	2017-12	08/28/2017
815-30-55-24	Amended	2017-12	08/28/2017
815-30-55-25	Amended	2017-12	08/28/2017
815-30-55-28	Amended	2017-12	08/28/2017
815-30-55-29	Amended	2017-12	08/28/2017
815-30-55-32	Amended	2017-12	08/28/2017
815-30-55-34 through 55-39	Superseded	2017-12	08/28/2017
815-30-55-41 through 55-43	Amended	2017-12	08/28/2017
815-30-55-49	Amended	2017-12	08/28/2017

Paragraph	Action	Accounting Standards Update	Date
815-30-55-54 through 55-57	Amended	2017-12	08/28/2017
815-30-55-60	Amended	2017-12	08/28/2017
815-30-55-61	Amended	2017-12	08/28/2017
815-30-55-62	Superseded	2017-12	08/28/2017
815-30-55-63	Amended	2017-12	08/28/2017
815-30-55-64	Amended	2017-12	08/28/2017
815-30-55-65	Superseded	2017-12	08/28/2017
815-30-55-66	Amended	2017-12	08/28/2017
815-30-55-70	Amended	2017-12	08/28/2017
815-30-55-72	Amended	2017-12	08/28/2017
815-30-55-75	Amended	2017-12	08/28/2017
815-30-55-81 through 55-83	Amended	2017-12	08/28/2017
815-30-55-89	Amended	2017-12	08/28/2017
815-30-55-91	Amended	2017-12	08/28/2017
815-30-55-93	Superseded	2017-12	08/28/2017
815-30-55-93A	Added	2017-12	08/28/2017
815-30-55-95	Amended	2017-12	08/28/2017
815-30-55-97 through 55-99	Amended	2017-12	08/28/2017
815-30-55-98A	Added	2017-12	08/28/2017
815-30-55-101	Amended	2017-12	08/28/2017
815-30-55-107	Amended	2017-12	08/28/2017
815-30-55-109	Amended	2017-12	08/28/2017
815-30-55-117	Amended	2017-12	08/28/2017
815-30-55-124	Amended	2017-12	08/28/2017
815-30-55-126	Amended	2017-12	08/28/2017
815-30-55-127	Amended	2017-12	08/28/2017
815-30-55-129	Amended	2017-12	08/28/2017
815-30-55-132	Amended	2017-12	08/28/2017
815-30-55-134 through 55-148	Added	2017-12	08/28/2017

38. Amend paragraph 815-35-00-1, by adding the following items to the table, as follows:

815-35-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-35-05-1	Amended	2017-12	08/28/2017
815-35-35-1	Amended	2017-12	08/28/2017
815-35-35-3 through 35-5	Amended	2017-12	08/28/2017
815-35-35-4A	Added	2017-12	08/28/2017
815-35-35-5A	Added	2017-12	08/28/2017
815-35-35-5B	Added	2017-12	08/28/2017
815-35-35-7	Amended	2017-12	08/28/2017
815-35-35-9 through 35-14	Amended	2017-12	08/28/2017
815-35-35-15	Superseded	2017-12	08/28/2017
815-35-35-16	Superseded	2017-12	08/28/2017
815-35-35-17	Amended	2017-12	08/28/2017
815-35-35-17A	Added	2017-12	08/28/2017
815-35-35-18 through 35-21	Amended	2017-12	08/28/2017
815-35-35-22 through 35-25	Superseded	2017-12	08/28/2017
815-35-35-26	Amended	2017-12	08/28/2017
815-35-40-1	Added	2017-12	08/28/2017
815-35-50-2	Superseded	2017-12	08/28/2017

39. Amend paragraph 820-10-00-1, by adding the following items to the table, as follows:

820-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Benchmark Interest Rate	Added	2017-12	08/28/2017
Credit Risk	Amended	2017-12	08/28/2017
Interest Rate Risk	Amended	2017-12	08/28/2017

40. Amend paragraph 954-225-00-1, by adding the following items to the table, as follows:

954-225-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
954-225-45-7	Amended	2017-12	08/28/2017

41. Amend paragraph 954-815-00-1, by adding the following item to the table, as follows:

954-815-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
954-815-45-1	Amended	2017-12	08/28/2017

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Costs and Benefits

BC2. An Update should provide information in its amendments that is useful in making business and economic decisions, and the benefits should justify the costs. Providing useful information means, among other things, producing economically "neutral" information (that is, information that faithfully represents the economic results of a transaction, regardless of perceived positive or negative effects of reporting that information) that permits users to make useful decisions on the basis of the financial information.

BC3. Paragraph OB2 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting—Chapter 1, The Objective of General Purpose Financial Reporting*, and Chapter 3, *Qualitative Characteristics of Useful Financial Information*, states the following:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [Footnote reference omitted.]

BC4. In considering the objective of general purpose financial reporting, the Board determined the objectives of the Update are to portray more clearly the effect of hedge accounting on an entity's financial statements and to reduce complexity in the hedge accounting model by making targeted improvements on the basis of the feedback received from preparers, auditors, users, and other stakeholders that align hedge accounting more closely with an entity's risk management activities. In determining targeted improvements, the Board also considered opportunities to achieve convergence with IFRS 9, *Financial Instruments*.

BC5. As part of the due process that led to the amendments in this Update, the Board conducted extensive outreach activities with users, preparers, and auditors of financial statements to obtain information about areas of complexity in Topic

815, Derivatives and Hedging, other opportunities to improve the hedge accounting model, and areas for which the financial reporting does not provide decision-useful information for users of financial statements.

BC6. The FASB's *Rules of Procedure* states the following:

The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports. [page 2]

BC7. In fulfilling that mission, the Board follows certain precepts, including the precept to promulgate Updates only when the expected benefits of the resulting information justify the expected costs. The Board strives to determine that an Update will fill a significant need and that the costs imposed to meet that Update, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information.

BC8. On the basis of extensive due process and significant input received from preparers, auditors, and financial statement users, the Board concluded that the targeted improvements to Topic 815 provide users with more relevant information on, and a more faithful representation of, hedging activities in a more cost-efficient manner for preparers. The amendments in this Update result in the following benefits:

- a. Expanding component hedging to nonfinancial risks for preparers to more accurately present, and users to better understand, an entity's risk exposures and risk management activities
- b. Eliminating the separate measurement and presentation of hedge ineffectiveness that has resulted in complexity in the financial reporting process and hindered the decision usefulness of reported information
- c. Aligning the financial reporting for hedges of interest rate risk with the economic results of those risk management activities
- d. Reducing the costs and complexity of monitoring the effectiveness of a hedging relationship by allowing more qualitative assessments
- e. Allowing more time for the preparation of hedge documentation for preparers that elect hedge accounting.

BC9. The Board's outreach activities also included discussions about the potential costs and feasibility of implementing its proposals for simplifying the hedge accounting guidance in Topic 815. The amendments in this Update reduce complexity and simplify areas of application within GAAP, thereby reducing costs for preparers and auditors. Additionally, users of financial statements are provided with a greater understanding of risk management activities and their effects on the financial statements through those targeted improvements.

BC10. The Board understands that certain reporting entities will incur implementation costs as a result of the amendments in this Update. However, because hedge accounting is optional within GAAP, not all reporting entities will bear the costs of the amendments. Therefore, any additional costs apply only to those entities that both mitigate certain market risks and elect to apply hedge accounting. The expected costs of the amendments include the following:

- a. Initial costs to educate employees about how to apply the targeted improvements and how to explain to users of financial statements the effects of the changes on an entity's financial statements
- b. Initial costs to update systems and processes to implement the targeted improvements in this Update.

BC11. The Board notes that after those implementation activities are completed, the ongoing costs for most entities of adopting the amendments in this Update likely will be lower than the costs of complying with the accounting model in current GAAP. The Board also notes that, based on substantial outreach with preparers of financial statements, many entities will be able to apply the amendments by using systems and processes that are similar to what they used in previous GAAP to meet those reporting and disclosure requirements.

BC12. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new requirements are borne primarily by current investors along with preparers who need to effectively communicate that information. The Board's assessment of the costs and benefits likely to result from issuing new requirements is unavoidably more qualitative than quantitative because there is no identified method to objectively quantify the costs to implement new guidance or to quantify the value of expected, improved information in financial statements.

BC13. Overall, the Board decided that the expected benefits of the amendments in this Update justify the expected costs.

Scope

BC14. The Board concluded that the types of items and transactions currently eligible for hedge accounting under Topic 815 continue to be eligible under the amendments in this Update. The issues that the Board considered in this project expand the number and types of transactions that qualify for hedge accounting.

Background Information

Previous Phases of the Project

BC15. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, was issued in 1998 and was effective for financial statements for fiscal years that began after June 15, 2000. Statement 133 established standards of financial accounting and reporting for derivative instruments and hedging activities. It also provided special optional hedge accounting to alter the normal accounting for one or more instruments included in a hedging relationship. That special hedge accounting in Statement 133 resulted from the need to address differences in the way hedged items and hedging instruments are recognized and measured and from the desire of entities to manage cash flow risk as well as manage the timing of recognition in income of the gains and losses on derivative hedging instruments.

BC16. Since the effective date of Statement 133, the Board was asked to address a number of issues related to various aspects of hedge accounting. As a result, in May 2007, the Board added a project to its agenda to reconsider the hedge accounting guidance in Statement 133.

BC17. After those deliberations were completed, the Board issued an Exposure Draft of a proposed Statement, *Accounting for Hedging Activities*, in June 2008. The Board also issued an Exposure Draft of a proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*, in May 2010. Both the 2008 and 2010 Exposure Drafts proposed similar amendments to hedge accounting, as discussed in the following paragraphs. In addition to hedge accounting, the 2010 Exposure Draft addressed proposed amendments to the classification and measurement and impairment of financial instruments.

BC18. The main proposals in the 2010 Exposure Draft regarding hedge accounting included:

- a. Lowering the qualifying threshold for hedge accounting from *highly effective* to *reasonably effective*. An entity also would have been allowed to assess hedge effectiveness qualitatively both at hedge inception and subsequently unless facts and circumstances changed.
- b. Prohibiting an entity from voluntarily dedesignating hedging relationships.
- c. Recognizing ineffectiveness for cash flow underhedges.
- d. Eliminating the shortcut and critical terms match methods.

BC19. The proposed amendments to the hedge accounting guidance in the 2010 Exposure Draft were largely consistent with the proposed amendments in the 2008 Exposure Draft with two notable exceptions:

- a. The Board decided not to carry forward the proposed amendment that would have prohibited an entity from designating particular risks in financial items as the risks being hedged and only recognizing the effects of the risks hedged in net income (commonly referred to as bifurcation-by-risk).
- b. The Board decided not to carry forward the proposed amendments to the guidance on hedging forecasted intra-entity transactions.

BC20. Much of the feedback received on the 2008 Exposure Draft focused on the proposed amendment that would have eliminated bifurcation-by-risk for hedging risks in financial instruments. Otherwise, the feedback received on the 2010 Exposure Draft generally was consistent with the feedback received on the 2008 Exposure Draft.

Feedback on the 2010 Exposure Draft

BC21. Of the 2,814 comment letters the Board received on the 2010 Exposure Draft, 248 addressed the Board's proposed amendments to hedge accounting.

BC22. Stakeholders also provided feedback on the 2010 Exposure Draft through other mechanisms, as described in the following paragraphs.

BC23. The Board received questionnaires from 28 investors and other users of financial statements. Users provided confidential feedback on a specifically designed investor questionnaire. Many of those users focused on sectors in which entities actively hedge their commodities risk, such as airlines and food producers. Of the 28, 13 were sell-side, 11 were buy-side, and 4 represented credit rating agencies.

BC24. The Board and staff conducted eight field visits with various entities to discuss the operability and costs and benefits of the 2010 Exposure Draft. Participants included banking institutions of various sizes, nonfinancial entities, and an insurance company.

BC25. The Board and staff received feedback through face-to-face meetings and calls from more than 120 investors and other users of financial statements who are employed by more than 60 firms and represent a variety of perspectives. Approximately 80 percent of those investors were buy-side analysts, with two-thirds of those buy-side analysts investing on a long-only basis, and the remainder employing a long/short strategy. The remaining users were (a) sell-side analysts specializing in either bank/insurance related sectors or accounting or (b) ratings agencies analysts. The Board and staff also received feedback from numerous preparers, auditors, valuation specialists, and regulators through face-to-face meetings or calls with individual organizations or professional associations.

BC26. The Board held 5 public roundtable meetings with more than 65 participants, including users, preparers, regulators, auditors, and others representing various perspectives.

BC27. Nonuser stakeholders generally supported lowering the *highly effective* threshold to *reasonably effective*. They also supported a move from quantitative to qualitative assessments of hedge effectiveness. However, there were concerns that the term *reasonably effective* was unclear and that a new quantitative threshold would develop in practice (for example, 60–167 percent or 50–200 percent), potentially creating diversity in practice. Additionally, most nonuser stakeholders commented that the proposed guidance on qualitative testing was too vague and that entities would simply continue to perform quantitative testing without additional guidance on when qualitative testing of hedge effectiveness would be acceptable.

BC28. Most nonuser stakeholders opposed the proposed amendment that would prohibit the voluntary dedesignation of hedges and the recording of ineffectiveness for cash flow underhedges. Preparers and auditors stated that they were unaware of any instances of abuse or earnings management related to voluntary dedesignation. They also noted that there are many valid hedging strategies that require frequent dedesignation and redesignation that would be prohibited under the proposal. In regard to cash flow underhedges, the majority of nonuser stakeholders disagreed conceptually with the proposal because it would require an entity to record the change in the fair value of the perfect hypothetical hedging derivative that the entity did not enter into rather than the actual hedging derivative that it did enter into.

BC29. Nonuser stakeholders had mixed views on the proposed amendment that would eliminate the shortcut method and the critical terms match method. Some supported elimination because of previous difficulties with compliance, and others supported retention because some entities lacked the resources to employ the long-haul method.

BC30. Additionally, some nonuser stakeholders urged the Board to consider other issues in its redeliberations, such as permitting additional benchmark interest rates and component hedging for nonfinancial assets.

BC31. Most users agreed with the Board's goal of simplifying hedge accounting. However, responses differed between nonfinancial and financial sector users about how and why hedge accounting should be simplified.

BC32. Nonfinancial sector users emphasized stability of revenue and margins. They highlighted that commodity prices have been increasingly volatile over the past few years. Many noted that *any* reduction in this volatility is good risk management. They maintained that valid economic hedging strategies should qualify for hedge accounting, including component hedges of nonfinancial assets. They were unsure why some valid hedging strategies initially qualify for hedge accounting and are later disqualified when the economic results of those

transactions (for example, locking in a price for a forecasted purchase of inventory) remain the same.

BC33. Financial sector users supported specialized accounting for risk management activities and were comfortable with the risk exposures that are eligible for hedge accounting under current GAAP. However, they were concerned about expanding eligible risks beyond those that are contractually specified.

BC34. Both financial and nonfinancial sector users commented that the concept of hedge ineffectiveness is hard to understand. Nonfinancial sector users stated that they view hedge ineffectiveness for cash flow hedges as part of the total cost of the input that should be disclosed each period but recognized when the hedged item affects earnings. Financial sector users maintained that although ineffectiveness was usually immaterial, it should be accurately measured and reported each period.

BC35. Users generally supported enhanced disclosures that would help them better understand an entity's risk exposures and risk management activities. Users want to better understand an entity's gross exposure to a particular risk, which risks are or are not being managed, what percentage of the entity's total exposure is being hedged and over what time period, the effects of hedging on future income and cash flows, and the degree of success of the entity's risk management activities.

BC36. Some users, particularly those who analyze financial services companies, noted that current hedge accounting is too complicated, obscures risks and, therefore, should be prohibited. They recommended that all financial instruments should be measured at fair value, thus avoiding the need for a separate hedge accounting model.

Deliberations Leading to This Update

BC37. The hedge accounting project remained inactive for a period of time until decisions on the classification and measurement of financial instruments neared finalization. In January 2014, the hedge accounting project was transferred to research status. During that phase of the project, the Board performed extensive additional outreach with stakeholders about the issues that should be addressed in the project.

BC38. In addition to the outreach on the previous proposals, during initial deliberations the Board and staff conducted 81 face-to-face meetings and calls with public accounting firms, 5 industry groups representing both financial and nonfinancial firms, 12 preparers from various industries (including financial services, insurance, airline, agriculture, manufacturing, lightweight metals, and technology), regulators, and 2 firms that provide hedge accounting services to public and private entities.

BC39. In November 2014, the Board transferred the hedge accounting project from research status to active status. The Board decided to pursue potential improvements to the existing hedge accounting model rather than create a new model, based on the view that hedge accounting is an exception to the standard classification and measurement of financial assets and liabilities. This view is consistent with the basis for the current model in Topic 815.

BC40. The Board decided that the topics that it would address in the initial deliberations of the project would be based on the feedback received on the 2010 Exposure Draft and additional outreach conducted. In particular, the Board decided to focus on the presentation and disclosure of hedging relationships as well as selected issues, including component hedging of nonfinancial assets; practice issues related to fair value hedges of interest rate risk (including revisiting benchmark interest rates); and simplifications regarding hedge effectiveness requirements and hedge documentation. The Board also wanted to consider whether the hedge accounting guidance in GAAP could align with aspects of the hedge accounting provisions of IFRS 9.

BC41. In September 2016, the Board issued proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The Board received 60 comment letters on the proposed Update.

BC42. In addition, stakeholders also provided feedback on the September 2016 proposed Update and subsequent redeliberation issues through the following channels:

- a. Outreach meetings with financial statement users. The Board received feedback from more than 30 investors and other users of financial statements who are employed by more than 20 firms through conference calls with individual investors representing a variety of perspectives. Approximately 45 percent of those investors were buy-side analysts, with two-thirds of those buy-side analysts investing on a long-only basis, and the remainder employing a long-short strategy. The remaining investors were sell-side analysts. Overall, the Board received user feedback from analysts specializing in a variety of sectors, including, but not limited to, banking and insurance, agriculture, metals and mining, oil and gas, telecom, airlines, and accounting.
- b. Public roundtable meetings. The Board held 2 public roundtable meetings on December 2, 2016, with 18 participants, including preparers, regulators, auditors, and others representing various perspectives.
- c. Private Company Council (PCC). The Board met with the PCC on December 13, 2016, to discuss private company hedge documentation issues.
- d. Other outreach meetings. The Board received additional feedback since the 2016 proposed Update through 70 face-to-face meetings and calls with public accounting firms, 2 industry groups, 13 preparers, regulators,

and 2 firms that provide hedge accounting services to public and private entities.

BC43. This stakeholder feedback is incorporated into the feedback of the individual issues discussed below.

Hedges of Nonfinancial Assets

BC44. Regarding hedging the risk of a nonfinancial asset, current GAAP permits an entity to designate the overall change in price as the hedged risk. Current GAAP prohibits an entity from designating changes in cash flows of a component of a nonfinancial asset as the hedged risk, with the exception of cash flow hedges of foreign exchange risk. This is different from the approach for hedges of financial instruments for which an entity may designate either the overall risk of changes in cash flows or one or more discrete risks as the hedged risk.

BC45. In the deliberations leading to this Update, the Board concluded that an entity should be permitted to designate the variability in cash flows attributable to changes in a contractually specified component in the contract as the hedged risk in a hedge of a nonfinancial asset. A contractually specified component is defined 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.

BC46. The Board decided that by allowing contractually specified component hedging for nonfinancial assets, an entity can more accurately reflect the effects of its risk management on its financial reporting. Furthermore, the Board believes that designating the variability in cash flows attributable to changes in a contractually specified component as the hedged risk is objective and is relatively straightforward to apply.

BC47. The Board understands based on outreach that many entities manage commodity price risk on a component basis rather than on a total-price-risk basis. The Board also understands that contracts for various types of commodities across various industries generally are priced based on a traded commodity index plus or minus a basis differential, which could include items such as transportation costs, quality or grade differentials between a "benchmark" quality of a commodity and the quality of the commodity the entity is actually purchasing, and local supply and demand factors for the commodity. Therefore, the total change in the price of the hedged item attributable to changes in the price of the commodity generally is easy to measure. In addition, the Board understands that derivative instruments are often only available at the component level.

BC48. Stakeholders emphasized that the current hedge accounting model results in hedge ineffectiveness recorded in current period earnings because an entity is required to incorporate aspects of the total price into the hedging relationship that the entity either cannot or chooses not to hedge. Outreach

participants asserted that reporting hedge ineffectiveness related to risks that the entity is not trying to hedge provides users of financial statements with confusing and potentially misleading information about the effectiveness of the entity's risk management activities.

BC49. The Board also understands that portfolio hedging of commodities on a total-price-risk basis is extremely challenging, particularly for situations in which an entity has suppliers for the same commodity in various locations. Although the contracts are priced based on the same traded commodity, the basis differentials of those contracts (for example, related to transportation costs) often create too much variability on a total-price-risk basis to enable an entity to obtain hedge accounting for these forecasted purchases on a portfolio basis. As a result, many entities choose not to hedge at all because of the cost and effort of separately hedging each contract from each supplier. Under the contractually specified component hedging model in this Update, an entity should more easily be able to designate the variability in cash flows attributable to changes in a contractually specified component from multiple suppliers as the hedged risk. The Board notes that this potentially could reduce an entity's costs and more closely align hedge accounting with its risk management activities.

BC50. Stakeholders also noted that risk management objectives frequently involve hedging the cash flow variability of forecasted transactions beyond the contractual period for existing contracts or for forecasted transactions before a contract is established (for example, a purchase in the spot market). Because the model included in this Update is based on a contractually specified concept, stakeholders questioned whether they could apply hedge accounting before or after the contractual period. In some instances, entities may enter into supply contracts for short-term periods that are renewed or may have procurement practices that affect the timing of execution of contracts for purchases or sales of nonfinancial assets. In other cases, an entity may be exposed to price risk before it enters into a contract. Therefore, an entity may be exposed to price risk beyond the term of the existing contract or even when no contract exists at all based on planned future purchases and sales of a nonfinancial asset that ultimately will become contractual in nature. Stakeholders indicated that hedging the cash flow variability of forecasted purchases or sales of nonfinancial assets before or after the contractual period in those instances is critical to properly manage price risk exposure. The Board agreed with that feedback and concluded that it is reasonable to permit an entity to apply cash flow hedge accounting to a not-yet-existing contract based on the analysis discussed in paragraphs BC55 and BC56 and if all other requirements for cash flow hedge accounting are met.

BC51. Despite the advantages of a component hedging model, the Board was concerned that an entity inappropriately could elect hedge accounting by fabricating a contractually specified component to which it does not have price exposure and then enter into a derivative to hedge that component. The Board also is concerned that an entity potentially could specify a component in a contract but may not have price exposure to it if other terms of the contract are written in

such a way that exposure to the component is mitigated or eliminated. In the proposed Update, the Board decided to address those concerns by creating criteria that had to be met for a contractually specified component to be designated as the hedged risk.

BC52. The guidance in the proposed Update would have required that (a) the purchase or sale contract created an exposure related to the variability in cash flows attributable to changes in the contractually specified component for the life of the hedging relationship, and if the exposure was limited, an entity had an expectation that the hedging relationship would be highly effective, (b) the stated components of the price of the nonfinancial contract all related to the cost of purchasing or selling the nonfinancial asset in the normal course of business in a particular market, and (c) all of the stated components of the price of the nonfinancial contract reflected market conditions at contract inception.

BC53. Stakeholders indicated that the guidance in (a) in paragraph BC52 was not incremental for cash flow hedging relationships because it reiterated the guidance in paragraphs 815-20-25-15(i)(3) and 815-20-25-100. Additionally, the Board added (b) and (c) in paragraph BC52 to prevent contractually specified components unrelated to the purchase or sale of the nonfinancial asset from being designated as the hedged risk. Stakeholders indicated that for an existing contract, applying the normal purchases and normal sales scope exception in combination with the embedded derivatives guidance in Topic 815 prevents any extraneous pricing feature from being designated as the hedged risk.

BC54. The Board agreed with that feedback and removed this proposed guidance from the amendments in this Update. New criteria were added in paragraph 815-20-25-22A that focus on how the results of assessing an existing contract for the normal purchases and normal sales scope exception in combination with the embedded derivative guidance should affect the designation of a contractually specified component as the hedged risk.

BC55. However, for contracts that do not exist at the time of hedge designation, an embedded derivative or normal purchases and normal sales analysis would not have been completed. Therefore, the Board concluded that if an entity expects that the criteria in paragraph 815-20-25-22A will be met in the future contract and all other cash flow hedging criteria are met, a contractually specified component may be designated as the hedged risk. Once the contract is executed, it will undergo the more rigorous analysis under the normal purchases and normal sales scope exception or embedded derivatives guidance.

BC56. The Board concluded that the expectation that the criteria in paragraph 815-20-25-22A will be met for a not-yet-existing contract should not be held to the same probable threshold as the occurrence of the hedged forecasted transaction. The Board cited the practical issues associated with applying the probable threshold encountered in practice. Therefore, the Board decided not to require any additional threshold related to the guidance in paragraph 815-20-25-22B.

BC57. In feedback on the proposed Update, stakeholders requested that the Board provide additional guidance on the nature and form of contracts that could contain a contractually specified component. However, the Board concluded that it was unnecessary to provide additional guidance on the legal nature of a contract that contains a contractually specified component because the central issue is not the legal nature of the contract but, rather, that the contractually specified component is *explicitly referenced* in the contract. The Board also agrees that the requirement to explicitly reference the component in the contract is fulfilled if the component is explicitly referenced in other agreements that support the price at which a nonfinancial asset will be purchased or sold.

BC58. In initial deliberations, the Board considered, but rejected, a variation of the contractually specified component model. This model would have encompassed all contractually specified components included in the Board's decision plus components that are not contractually specified but for which it is the "market convention" to use the component as an underlying basis for determining the price of the overall product. That is, market participants in a particular commodities market would know the pricing conventions in that market. Under this alternative, a contract exists, but the components that would be eligible to be designated as the hedged item are not contractually specified. The Board rejected this model because the concept of market convention would be difficult to define across industries, would lead to confusion in instances in which there was no market convention or there were multiple market conventions, and potentially could be difficult to demonstrate objectively to third parties. The Board also concluded that contracts could be written to contractually specify the convention in situations in which a market convention exists, thereby making the variability in cash flows attributable to changes in the component an eligible hedged risk.

BC59. In feedback on the proposed Update, some stakeholders asked the Board to reconsider the market convention concept or consider the IFRS 9 approach that allows an entity to hedge a risk component that is separately identifiable and reliably measurable. Those stakeholders maintained that there are market conventions for some commodities that are understood by market participants without needing to write contracts to explicitly reference a contractually specified component. However, other stakeholders did not support expanding the contractually specified component model to the market convention concept. Therefore, the Board rejected those proposals because it was still concerned that there may not be market conventions for all commodity types across all markets and that it would be difficult to demonstrate that the change in price of a component that is not contractually specified has a direct and measurable effect on the total price of the nonfinancial asset. Overall, the Board concluded that the costs and judgments required to implement the contractually specified component model to be less than the costs and judgments required to implement a standard based on the market convention concept.

Changes in the Designated Component in a Hedged Forecasted Transaction

BC60. In a model in which a contractually specified component of the overall price can be hedged for a not-yet-existing contract, the contractually specified component in the contract that ultimately is executed may differ from the contractually specified component originally designated.

BC61. The proposed Update included implementation guidance on a hedging relationship involving the variability in a contractually specified component associated with a not-yet-existing contract. The implementation guidance illustrated a circumstance in which the contractually specified component in the executed contract differed from the contractually specified component that was expected to be present in the contract at hedge inception and designated as the hedged risk. The illustration concluded that if the executed contract references a different contractually specified component from the originally designated contractually specified component, an entity should discontinue hedge accounting because the designated hedged risk is not present in the executed contract.

BC62. In feedback received on the proposed Update, some stakeholders noted that there should not be an automatic dedesignation of the hedging relationship in all instances in which the hedged risk changes. They favored more flexibility to avoid automatic dedesignation even if the hedged risk differs from the hedged risk that was originally specified. Some stakeholders noted that an entity should not be penalized by being forced to discontinue hedge accounting if a change in a contractually specified component occurs (for example, the same commodity is being purchased but the grade of the commodity changes). Those stakeholders maintained that, in many circumstances, a change in a contractually specified component occurs for reasons that are external to the company executing the hedge. Furthermore, despite the change in the contractually specified component after initial designation, the hedge may remain a valid economic hedge. However, an automatic dedesignation of the hedge suggests the opposite. Generally, stakeholders that supported more flexibility maintained that an entity should be able to rely on whether the hedging instrument remains highly effective at offsetting the cash flows of the hedged forecasted transaction when the designated risk component changes.

BC63. Because of stakeholders' feedback on this issue, the Board decided to reconsider the proposed guidance on whether a change in the designated hedged risk in a cash flow hedge of a forecasted transaction would require dedesignation.

BC64. The Board observed that while this is a new issue for nonfinancial hedges, this issue exists in GAAP for hedges of financial items because of the bifurcation-by-risk model for financial hedges and the potential for changing from one index rate to another. An example illustrating a cash flow hedge of forecasted interest payments in paragraphs 815-30-55-52 through 55-62 concluded that a change in the hedged item's index requires the hedging relationship to be

dedesignated because the hedging instrument does not effectively offset the cash flows associated with future interest payments indexed to the revised index. However, for reasons consistent with the guidance on the nonfinancial example discussed in paragraph BC61, that illustration was revised in the proposed Update to conclude that a change in the contractually specified interest rate would have resulted in discontinuation of the hedge. Given the feedback on the nonfinancial example, the Board decided to address the revised conclusion for this financial example as well to ensure consistency between how a change in the hedged risk is treated for cash flow hedges of both nonfinancial and financial items.

BC65. The Board agreed with stakeholders' feedback that if an entity designates a hedged risk that changes in the future, that change should not result in an automatic dedesignation of the hedging relationship. The Board concluded that the hedging relationship could be continued if the hedging instrument provided highly effective offset in relation to the revised hedged risk. The Board acknowledged that this decision effectively would override the general guidance in paragraph 815-20-55-56, which indicates that a change to any of the critical terms of a hedging relationship is accomplished through a dedesignation of the original hedging relationship and the designation of a new hedging relationship. The Board concluded that because it decided to allow entities to designate as the hedged risk the variability in cash flows attributable to changes in a contractually specified component, some flexibility was needed to enable entities to apply that guidance without concern about automatic dedesignation if the hedged risk changes. The Board observed that a unique attribute of a cash flow hedge of a forecasted transaction is that an entity's expectation about the terms of the transaction as established at hedge inception may change during the forecast period, but the forecasted transaction may remain probable of occurring and the hedging relationship may remain highly effective based on the revised terms. The Board believed that, in those circumstances, requiring a dedesignation of the original hedging relationship and a redesignation of a new hedging relationship would not reflect risk management objectives. The Board also observed that its decision aligns with the guidance in current GAAP for applying the critical terms match method if a critical term changes, such that an entity may use a long-haul method of assessing hedge effectiveness rather than automatically discontinuing hedge accounting.

BC66. The Board also considered, but rejected, an alternative that would have required that hedge documentation encompass all of the possible hedged risks that might exist in the actual transaction(s) when it occurs. Consistent with that documentation, hedge effectiveness testing would have had to include all of the documented hedged risks to determine whether the derivative designated as the hedging instrument would be highly effective both at inception and over the life of the hedge. Under that alternative, if the hedged risk in the actual transaction(s) differs from the documented hedged risks, the hedge would be dedesignated. Although this alternative would have been a means to achieve flexibility in situations in which the hedged risk may change, the complexity that would have

been created by documenting multiple potential hedged risks and performing effectiveness tests associated with multiple hedged risks each period was too great. The Board also considered a variation of this alternative in which a change in the hedged risk would have constituted a missed forecast, requiring an immediate reclassification of amounts deferred in accumulated other comprehensive income to earnings. The Board rejected this approach because a change in the designated hedged risk is not a missed forecast and that a missed forecast would occur only if it becomes probable that the hedged forecasted transaction will not occur. The Board acknowledges that these rejected alternatives may be applied in practice today and that its decision may result in a change in practice.

BC67. The Board concluded that reasonable outcomes will be generated by documenting the expected hedged risk at inception of a hedging relationship and performing a single hedge effectiveness assessment based on the hedged risk currently expected to occur in the forecasted transaction.

BC68. The Board concluded that this approach will further minimize the complexity of (a) documentation and effectiveness testing and (b) circumstances in which a highly effective hedge would be dedesignated because of documentation technicalities. The Board considers this relief to be consistent with its decision on the shortcut method to allow hedge accounting to continue in instances in which the relationship remains highly effective. That is, if the hedging relationship continues to be highly effective, the hedging relationship should not be automatically dedesignated.

Benchmark Interest Rates

BC69. Current GAAP defines *interest rate risk* uniformly for both fair value and cash flow hedges as the risk of changes in a hedged item's fair value or cash flows attributable to changes in the designated benchmark interest rate. The concept of the benchmark interest rate was created in FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*, to permit entities to hedge interest rate risk without considering credit risk. Current GAAP defines the term *benchmark interest rate* based on stringent characteristics, including a concept that the rate be *risk-free*. Paragraph 815-20-25-6A explicitly specifies three eligible benchmark interest rates in the United States: Direct Treasury Obligations of the U.S. Government (UST), the London Interbank Offered Rate (LIBOR) Swap Rate, and the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate [OIS]).

BC70. In feedback received on the 2010 Exposure Draft and the proposed Update, stakeholders indicated that they would prefer the Board to take a more flexible approach to hedging interest rate risk. They maintained that the Board either should increase the number of allowable benchmark rates or move to a more principles-based approach for determining benchmark rates.

BC71. Stakeholders identified the SIFMA Municipal Swap Rate as an interest rate entities seek to hedge in addition to the benchmark rates already allowable under GAAP. SIFMA is the average rate at which high-credit-quality U.S. municipalities may obtain short-term financing and currently is the predominant rate referenced in issuances of municipal bonds. Based on stakeholders' feedback, the Board understands that markets for financial instruments referencing this rate are considered large, important, and liquid, and there is widespread demand for hedging that rate.

BC72. The Board decided to amend the guidance for hedging interest rate risk of financial instruments in both fair value and cash flow hedges. Specifically, the Board decided to redefine the term *interest rate risk* for the purposes of designating changes in fair value or variability of cash flows attributable to interest rate risk, as follows:

- a. For variable-rate financial instruments, interest rate risk will be the risk of changes in the hedged item's cash flows attributable to changes in the contractually specified interest rate in the agreement (see discussion in the next section).
- b. For fixed-rate financial instruments, interest rate risk will be the risk of changes in the hedged item's fair value attributable to changes in the designated benchmark interest rate. The Board decided to add the SIFMA Municipal Swap Rate to the list of acceptable benchmark rates in the United States as an eligible benchmark interest rate for hedging fixed-rate tax-exempt financial instruments.

BC73. The Board considered, but rejected, adding the prime composite indexes to the definition of a benchmark interest rate because it was concerned that the prime rates may contain an element of credit risk. The Board understands that in the current market environment, financial institutions generally set their prime rate at a fixed spread above the Fed Funds target rate. Stakeholders maintained that the spread above the Fed Funds target rate is attributable to a "break even" rate that represented the cost of servicing numerous prime-based consumer loans with relatively small principal balances. However, the Board observes that the entire spread may not relate to costs of servicing because some loan customers are granted rates less than the prime rate, thus implying that there is an element of credit risk. Furthermore, the Board understands that entities primarily want to hedge the prime rate when designating cash flow hedges (that is, when the prime rate is the contractually specified rate in a variable-rate financial instrument). Thus, the Board decided that adding a composite prime index to the list of permissible benchmark rates was unnecessary.

BC74. The Board also considered, but rejected, an approach that would have broadened the definition of *benchmark interest rate* for all hedges of interest rate risk and that would have allowed a more principles-based approach in selecting rates that could be hedged. This approach would have eliminated both the requirement that a benchmark rate be risk free and the list of explicitly permissible

benchmark rates under GAAP. Instead, an entity would have had the flexibility to select interest rate indexes based on market-driven factors or to choose rates important to the individual entity. However, the Board was concerned about allowing interest rate indexes as benchmark rates that potentially could incorporate a high level of credit risk. Although the Board rejected this proposal, it acknowledged a difference between hedging interest rate risk related to variable-rate financial instruments and fixed-rate financial instruments. Therefore, the Board decided to eliminate the benchmark interest rate concept for variable-rate financial instruments but retain it for fixed-rate financial instruments and included that approach in the proposed Update.

BC75. In feedback on the proposed Update, stakeholders generally supported that approach for hedging interest rate risk. They also expressed overall support for adding the concept of expectations that a rate *will become widely used* to the definition of the term *benchmark interest rate* to allow for the use of additional rates beyond the explicit list of eligible benchmark rates in the United States for hedges of fixed-rate financial instruments. Some respondents noted that this would avoid standard-setting activity each time an important new rate emerges in the marketplace and that it would assist in determining eligible benchmark rates outside the United States. In redeliberations, the Board affirmed the approach in the proposed Update, including retaining the definition of the term *benchmark interest rate* and the list of eligible rates in the United States and adding the SIFMA Municipal Swap Rate. The Board rejected adding the concept of expectations that a rate *will become widely used* to the definition of *benchmark interest rate* because the need to consider new eligible benchmark rates in the United States should not arise frequently. In addition, it has not perceived practice problems in identifying benchmark rates outside the United States.

BC76. The Board recognizes that substantial support for a more flexible approach to determining benchmark rates in the United States came from financial institutions. Those stakeholders highlighted the work of the Alternative Reference Rate Committee (ARRC), a consortium of major financial institutions in the United States convened by the Federal Reserve, to identify an alternative reference interest rate to LIBOR for U.S. financial markets. Financial institutions stated that any market benchmark rate recommended by the ARRC should be added as a benchmark interest rate for hedging purposes in GAAP expeditiously.

BC77. The Board acknowledges the Federal Reserve's initiative and the importance that emerging benchmark rates have in the marketplace. Therefore, the Board is prepared to add to the list of eligible benchmark rates as necessary when those rates emerge. The Board understands that the ARRC has identified its preferred alternative reference rate and is prepared to add a project to its agenda to consider adding that rate to the list of eligible benchmark rates when the Board and the Federal Reserve deem it appropriate. The Board observed that its decision to add the OIS rate in 2013 exemplified that the current standard-setting process enabled the Board to use judgment in considering the relevant aspects of

that rate, including its emerging importance in the marketplace. The Board notes that there was no impediment to resolving that issue in a timely manner.

Variable-Rate Financial Instruments

BC78. The Board decided to eliminate the requirement to designate variability in cash flows attributable to the benchmark interest rate as the hedged interest rate risk for cash flow hedges of existing variable-rate financial instruments (and forecasted issuances or purchases of variable-rate financial instruments). Instead, an entity may designate the variability in cash flows attributable to the contractually specified interest rate as the hedged interest rate risk.

BC79. Under current GAAP, if the explicit index in the variable-rate instrument is a nonbenchmark rate such as a composite prime index, the hedging relationship must include cash flow variability related to changes in all factors (including credit risk). The Board understands that this requirement for non-benchmark-based instruments creates significant complexity, for example, in hedging portfolios of prime-based loans. Because total variability in cash flows (including credit spreads) must be considered, any changes in the composition of the portfolio (for example, the prepayment of old receivables and the origination of new receivables with different credit spreads) could cause the overall hedged portfolio cash flows to change in a manner disproportionate to the change in the cash flows on the derivative designated as the hedging instrument. This could cause the hedging relationship to fall short of the highly effective threshold in subsequent periods and potentially necessitate a dedesignation of the existing hedging relationship and designation of a new hedging relationship going forward. Consequently, complex workarounds were developed to achieve hedge accounting for non-benchmark-based portfolios. Stakeholders noted that those workarounds would be unnecessary if the Board allowed more benchmark interest rates or a more flexible approach to hedging variable-rate financial instruments.

BC80. Similarly, for hedges of variable-rate instruments referencing the SIFMA Municipal Swap Rate, stakeholders indicated that entities that want to manage their tax-exempt exposure under current GAAP must enter into hedging strategies using proxy hedges by designating, for example, 65 percent of a LIBOR swap rate (or another rate that represents 1 minus the tax rate) that effectively could hedge a tax-exempt exposure. However, stakeholders indicated that changes in the supply and demand of tax-exempt instruments lead to rate variations specific to that market. Therefore, the relationship between taxable indexes and tax-exempt indexes may not remain stable. Thus, an interest rate swap referencing SIFMA would best achieve effective risk management in the tax-exempt market.

BC81. For variable-rate financial instruments, the Board agreed with stakeholders that entities have cash flow exposure to the contractually specified interest rate regardless of whether it is a benchmark interest rate or not. Therefore, the Board decided to eliminate the benchmark interest rate concept for hedges of

variable-rate financial instruments because changes in the cash flows attributable to the explicit rate referenced in the agreement are clearly measurable. This approach would be difficult to manipulate because the remaining components of the interest rate of a debt instrument typically represent a fixed spread related to credit risk and other factors related to the borrower that are well understood and verifiable. The Board agreed with stakeholders that the objective of hedging variable-rate debt instruments is the same for financial instruments with indexes based on benchmark rates and nonbenchmark rates, that is, to convert cash flows from floating rate to fixed rate. The Board observed that contractually specified interest rates are not limited to market benchmark rates. An entity's own prime rate or a variable rate set via an auction process qualifies as a contractually specified interest rate when it is the rate that is explicitly referenced in the variable-rate financial instrument being hedged, thereby resolving the issues in paragraph BC79.

BC82. The Board concluded that aligning cash flow hedge accounting for variable-rate financial instruments with an entity's risk management activities benefits both preparers and users of financial statements because preparers will be able to reflect their risk management activities more accurately in their financial statements and users will have access to more decision-useful information. Those benefits should outweigh any costs of implementation.

BC83. The Board notes the similarity between its decisions on hedges of variable-rate financial instruments and forecasted purchases of nonfinancial assets, that is, a "contractually specified" concept. The Board observes that there is conceptual merit in the use of an internally consistent concept for cash flow hedges of both financial instruments and nonfinancial items.

Forecasted Issuances or Purchases of Debt Instruments

BC84. The Board acknowledges that its decision to have different concepts for designation of interest rate risk hedges for fixed-rate financial instruments and variable-rate financial instruments affects the designation and documentation of hedges of forecasted issuances or purchases of debt instruments (or the coupon payments associated with those instruments). The Board understands that, in some cases, an entity that forecasts an issuance or purchase of a debt instrument may know in advance of that issuance or purchase whether the financial instrument will be fixed rate or variable rate. However, in other cases, an entity may not know in advance of the actual issuance or purchase whether the financial instrument will be fixed rate or variable rate. For example, in instances in which an entity is forecasting an issuance of debt, the entity's funding decision may not occur until close to the actual issuance date of the debt. As a result, the Board decided that in instances in which an entity does not know at the inception of the hedging relationship whether the forecasted issuance or purchase of a debt instrument will be fixed rate or variable rate, the entity may designate as the hedged risk the variability in the coupon payments attributable to a rate that will

qualify both as a benchmark interest rate (if the instrument ultimately issued is fixed rate) and as a contractually specified interest rate (if the instrument ultimately issued or purchased is variable rate). For example, if the entity designated the variability of the LIBOR rate as the hedged risk associated with a forecasted debt issuance, that rate will qualify as a benchmark rate if fixed-rate debt was issued and also will qualify as a contractually specified interest rate if variable-rate debt indexed to LIBOR was issued.

BC85. If an entity designated and documented as the hedged item the forecasted issuance of variable-rate debt but issues fixed-rate debt and if the contractually specified interest rate designated as the hedged risk also qualifies as a benchmark interest rate (for example, LIBOR), the designated interest rate risk is for practical purposes based on the same rate. Similarly, if an entity forecasted an issuance of fixed-rate debt but issued variable-rate debt and if the benchmark interest rate initially designated as the hedged risk also is the contractually specified interest rate on the debt (for example, LIBOR), the designated interest rate risk is for practical purposes based on the same rate. In both cases, amounts recognized in other comprehensive income will not be immediately reclassified to earnings because the hedged cash flows are still probable of occurring.

Selected Issues Related to Fair Value Hedges of Interest Rate Risk

BC86. The fair value hedging model in current GAAP requires the hedged item to be identified as one of the following:

- a. All of a recognized asset or liability (or unrecognized firm commitment)
- b. A specific portion of a recognized asset or liability, unrecognized firm commitment, or portfolio of similar items
- c. A portfolio of similar assets or similar liabilities designated according to (a) or (b).

BC87. Under current GAAP, the portion of a recognized asset or liability must be a percentage of an entire asset or liability, one or more selected cash flows, or a put or call option. In a portfolio, the portion must relate to each item in the portfolio. These limitations lead to recognizing hedge ineffectiveness or the inability to achieve hedge accounting for hedging strategies that achieve perfect or near-perfect economic hedges.

BC88. Stakeholders expressed the following concerns about those limitations, which are discussed in more detail in each subsection below:

- a. Cash flows related to the hedged item are required to include credit risk that is not part of the risk management activity and generates ineffectiveness in earnings

- b. Hedge accounting cannot be achieved for a strategy that results in converting fixed-rate cash flows to a floating rate for a portion of the term of a financial instrument
- c. Prepayment risk must be measured based on changes in interest rate risk and all other idiosyncratic factors
- d. Hedging portfolios of prepayable financial assets is operationally burdensome and requires frequent (and in some cases, daily) redesignations and redesignations.

BC89. These concerns do not exist for cash flow hedges. However, stakeholders noted that when converting cash flows from a fixed rate to a variable rate (a fair value hedge) or floating rate to a fixed rate (a cash flow hedge), the risk management objective is the same—to convert cash flows. In this project, the Board considered that fact and concluded that if the risk management objective in the two scenarios is the same (converting cash flows), then the hedge accounting construct (fair value hedge versus cash flow hedge) should not affect whether hedge accounting could be applied. For those reasons, and to reduce some of the complexity that historically has made the fair value hedging model more restrictive than the cash flow hedging model, the Board decided to address these issues.

Total Coupon or Benchmark Rate Coupon Cash Flows

BC90. Current GAAP requires the use of the total contractual coupon cash flows in determining the change in the fair value of the hedged item attributable to interest rate risk. Stakeholders maintain that assessing hedge effectiveness and measuring ineffectiveness using the total coupon cash flows misrepresent true hedge effectiveness by incorporating credit factors into the calculation. Stakeholders emphasized that they are not trying to manage credit risk when entering into an interest rate swap designated as a hedge of a fixed-rate financial instrument and stated that changes in the value of the credit spread inherent in the total coupon should not be portrayed as hedge ineffectiveness in earnings. Stakeholders broadly supported allowing entities to assess effectiveness using only the benchmark rate coupon cash flows. The issue of which cash flows should be used in calculating the change in the fair value of the hedged item attributable to interest rate risk was examined before the issuance of Statement 138. The Board at that time was concerned that allowing only a portion of the total interest coupon would enable an entity, in essence, to designate as the hedged item a high-credit-quality debt instrument embedded in the actual debt instrument that the entity issued.

BC91. The Board agreed with stakeholders' feedback and decided to permit an entity to use benchmark rate coupon cash flows determined at hedge inception in calculating the change in the fair value of the hedged item attributable to interest rate risk in the proposed Update. Unlike the view under Statement 138, the Board did not view this as an issue of hedge designation but rather as a mechanical issue of how to calculate the change in the fair value of the hedged item attributable to interest rate risk. For practical reasons, the Board also decided to propose that an

entity could elect to use either the total coupon cash flows or benchmark rate coupon cash flows. For example, an entity may have a borrowing rate that is close to the benchmark rate and may not want to change its methodology because the effect would not be significant enough to justify the cost of complying with the change.

BC92. The Board also considered whether there should be some limitation on the use of benchmark rate coupon cash flows if the benchmark rate is greater than the total contractual coupon rate (sub-benchmark hedges). This issue can arise when a hedge is designated upon the issuance of a debt instrument for a high-credit-quality borrower or in a hedging relationship designated after the issuance of the debt instrument (late hedge) when there are changes in interest rates between the issuance date and the date of hedge designation. Specifically, the Board considered whether the total coupon cash flows should be used to determine the change in the fair value of the hedged item attributable to interest rate risk when the fixed coupon cash flows are less than the cash flows associated with the benchmark rate.

BC93. To address that issue, the Board included in the proposed Update a requirement that if, at hedge inception, the current market yield of the hedged item is less than the benchmark interest rate, an entity would be required to use the full contractual coupon cash flows of the entire hedged item in calculating the change in the hedged item's fair value attributable to changes in the benchmark interest rate (market yield test). This method is similar to that used in IAS 39, *Financial Instruments: Recognition and Measurement*, and IFRS 9. The Board proposed this test to allow an entity to consider the market environment and the economics of the debt instrument being hedged at the time of hedge designation (as opposed to simply looking at the contractual coupon, which was based on the market environment at the time of the earlier debt issuance).

BC94. In feedback on the proposed Update, some stakeholders questioned whether using the benchmark coupon cash flows to measure the fair value of the hedged item as restricted by the market yield test was appropriate. The market yield test results in credit factors being incorporated into the calculation of changes in fair value of the hedged item attributable to interest rate risk for sub-benchmark issuers with high credit quality, while above-benchmark issuers with lower credit quality would be able to exclude credit factors from that calculation. Therefore, under the proposal, high-credit-quality issuers would have had less advantageous accounting relative to low-credit-quality issuers. Some stakeholders also maintained that imposing the market yield test causes the fair value and cash flow hedging models to be asymmetrical. While cash flow hedges allow for the isolation of changes in the benchmark interest rate when a credit spread is positive or negative, fair value hedges would not allow for this same isolation when the market yield test fails (that is, debt is issued with a negative credit spread to the benchmark rate).

BC95. The Board agreed with stakeholders and decided to eliminate the market yield test in this Update. In reaching this decision, the Board also considered that the benchmark interest rate is an accounting notion that was designed to be a proxy for a risk-free rate for hedging purposes. Therefore, the accounting model should remain neutral when that proxy reflects a level of credit risk that is different from the credit risk inherent in the hedged item. Additionally, the Board found it persuasive that an entity's risk management objective is to convert cash flows, regardless of whether the fair value or cash flow hedging model is being applied, and agreed that the accounting construct that is applied should not give rise to different outcomes. Therefore, the Board decided that an entity should be permitted to measure changes in fair value of the hedged item using benchmark coupon cash flows regardless of whether the fixed coupon rate includes a positive or negative spread to the benchmark rate.

BC96. Additionally, the Board decided that the benchmark rate coupon method provides a more economically realistic analysis, particularly in late hedge situations (when the debt instrument is hedged sometime after its issuance) in which interest rates have changed from the time the debt was issued to the date of hedge designation. Given the ability to achieve perfect offset in a late-term hedge, the Board observes that its decision allows fair value hedging to be applied to late-term hedges under both the long-haul method and the shortcut method without raising a concern in paragraph 815-20-25-104(g)(2) when applying the shortcut method.

Hedges of Prepayable Financial Instruments

BC97. The Board decided that if an entity designates interest rate risk of a prepayable financial instrument that can be settled before its scheduled maturity in accordance with paragraph 815-20-25-6, the entity may consider only how changes in the benchmark interest rate affect the decision to settle the financial instrument before its scheduled maturity. For example, an investor in a debt instrument can consider only how changes in the benchmark interest rate will affect an obligor's decision to call the debt instrument. It is not required to consider all factors that will affect the decision to settle the financial instrument before its scheduled maturity when assessing hedge effectiveness and measuring the change in fair value of the debt attributable to changes in the benchmark interest rate.

BC98. Paragraph 815-20-25-6 states that the effect of an embedded prepayment option should be considered in designating a hedge of interest rate risk. Practice has interpreted this requirement to mean that an entity must consider all factors that might lead it to settle the financial instrument before its scheduled maturity (for example, changes in interest rates, credit spreads, or other factors) even if it has designated only interest rate risk as the risk being hedged.

BC99. Stakeholders indicated that estimating the fair value of the prepayment option to the level of precision required in the current reporting and regulatory environment is virtually impossible because an entity is required to incorporate credit and all other idiosyncratic factors that would affect the prepayment option. Stakeholders preferred that an entity be required to consider only how changes in the benchmark interest rate affect the likelihood of settlement before scheduled maturity. They also emphasized that allowing a prepayment option to be modeled considering only the changes in the benchmark interest rate more closely aligns the accounting for those hedges with an entity's risk management activities and more accurately reflects the change in the fair value of the hedged item attributable to interest rate risk. The Board agreed with those views.

Hedging a Portion of a Recognized Financial Instrument

BC100. The Board concluded that when one or more consecutive cash flows of a debt instrument are designated as part of the hedged item in a hedge of interest rate risk, an entity may measure the change in the fair value of the hedged item attributable to interest rate risk by using an assumed term that begins when the first hedged cash flow begins to accrue and ends when the last hedged cash flow is due and payable. The assumed maturity of the hedged item occurs on the date in which the last hedged cash flow is due and payable.

BC101. Current GAAP permits identification of one or more contractual cash flows, including one or more interest payments during a selected portion of the term of a debt instrument (such as the portion of the asset or liability representing the present value of the interest payments in the first two years of a four-year debt instrument) as the hedged item in a fair value hedge. While partial-term hedges are not prohibited, the guidance acknowledges that it often will be difficult to obtain a derivative that will meet the (highly effective) offset requirement. The main reason for this is that the principal repayment of the debt occurs at a different time than the maturity date of the interest rate swap.

BC102. Stakeholders indicated that the partial-term fair value hedging model under GAAP does not align with an entity's risk management activities. They stated that treasurers view risk management as managing cash flows (such as managing the fixed to floating cash flow profile). However, the mechanics of fair value hedging often prevent an entity from obtaining hedge accounting for swapping fixed cash flows to floating cash flows.

BC103. Stakeholders noted that a partial-term cash flow hedge (swapping floating cash flows to fixed cash flows) can be highly effective under GAAP because effectiveness is assessed using the hypothetical derivative method. Under that method, an entity compares the change in fair value of the hedging derivative with a hypothetical derivative that is the perfect hedge of the cash flows designated as the hedged item. For example, the perfect hypothetical derivative is a two-year derivative if the designated hedged item is the first two years of interest payments

on a five-year floating rate bond. This results in comparing the change in the fair value of the actual derivative (two-year swap) with the change in the fair value of the hypothetical derivative (two-year swap). Assuming the other terms are closely aligned, the hedging relationship likely will be highly effective.

BC104. The Board agreed with stakeholders and decided to amend the partial-term fair value hedging guidance. The Board concluded that there should be equitable treatment for partial-term fair value and cash flow hedges. The Board notes that this treatment achieves convergence of GAAP and IFRS. Specifically, IAS 39 and IFRS 9 allow an entity to make a simplifying assumption for hedge accounting purposes that the hedged item has the same implicit maturity date as the hedging instrument, thus enabling the hedging relationship to achieve highly effective offset.

BC105. In feedback received from stakeholders, preparers requested that the Board clarify the period over which basis adjustments should be amortized when the partial-term hedging guidance is applied to measure the hedged item. Consistent with its basis for conclusions in Accounting Standards Update No. 2017-08, *Receivables—Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*, the Board concluded that the accounting for basis adjustments made to the carrying value of the hedged item in an existing hedging relationship should be performed in accordance with an entity's hedging policies. Those policies typically would account for the basis adjustment over the life of the hedging relationship, which the Board believes would naturally be a shorter period for a partial-term hedge. Once a hedging relationship is terminated, amortization of adjustments made to the carrying value of the hedged item should be performed in a manner consistent with the amortization of all other premiums or discounts associated with the hedged item in accordance with other applicable Topics.

BC106. The Board concluded that the partial-term hedging guidance also addresses some of the concerns associated with hedging prepayable instruments. For a callable financial instrument, if the end of the partial-term period is on or before the date on which the instrument can initially be repaid, the hedged item created for hedge accounting purposes would essentially be noncallable. In that case, prepayment risk need not be considered when performing assessments of hedge effectiveness and measurements of changes in fair value of the hedged item. This aligns with how prepayment risk is considered in a cash flow hedge for a callable instrument.

Hedging a Portfolio of Prepayable Financial Assets or Beneficial Interests Secured by a Portfolio of Prepayable Financial Instruments

BC107. The Board's decisions on the use of benchmark rate coupon cash flows, partial-term hedges, and hedges of prepayable financial instruments for fair value hedges of interest rate risk were included in the proposed Update. In feedback received on the proposed Update, stakeholders generally supported those decisions and noted that the only significant remaining limitation for fair value hedges of interest rate risk is the effect of prepayment risk on financial assets that can be prepaid at any time after issuance. Some stakeholders requested that the Board consider allowing more flexibility in hedging portfolios of prepayable financial assets.

BC108. Before the issuance of this Update, the guidance in Topic 815 on portfolio hedges reflected an underlying premise that hedge accounting generally should be applied to individual assets or liabilities or portions of individual assets or liabilities. Because of this limitation, prepayment risk at an individual asset level must be considered because it has a significant effect on the fair value of fixed-rate prepayable financial instruments. Therefore, hedging portfolios of prepayable financial assets is operationally burdensome and requires frequent (and in some cases, daily) dedesignations and redesignations to comply with fair value hedge accounting requirements.

BC109. The Board decided to address this issue in redeliberations through the last-of-layer method. The Board concluded that this method will increase the alignment of the fair value hedging treatment of prepayable financial assets with the cash flow hedging model by excluding prepayment risk from the measurement of the hedged item when certain conditions are met. Under the last-of-layer method, the hedged item can be designated as a stated amount remaining in a closed portfolio of prepayable assets. Thus, the entity expects that risks arising from prepayments, defaults, and other factors affecting the timing and amount of cash flows do not relate to the layer designated as the hedged item.

BC110. The designation of the hedged item under this method is the inverse of how the hedged item is designated in a cash flow hedge of a forecasted transaction (that is, an unrecognized asset or liability) in which the hedged item is designated as the "first dollar amount." Because there are similarities between the approaches, the Board concluded that the level of documentation required in Topic 815 to make the last-of-layer method operable in most aspects should be similar to the level of documentation required in Topic 815 for the "first dollar amount" approach.

BC111. In practice, the "first of" threshold for a cash flow hedge is set to an amount that the entity knows it will surpass during the life of the hedging relationship. The inverse is true under the last-of-layer method in which the hedged

item is a recognized asset. The recognized asset balance is diminishing, and the “last of” threshold should be set to an amount that the entity expects will be outstanding as of the hedged item’s assumed maturity date.

BC112. The Board notes that this approach is operable only by using a combination of elections that result from the amendments in this Update because otherwise the assets would not be viewed as similar assets for hedge accounting purposes. Specifically, an entity is required to elect to hedge interest rate risk for a portion of the remaining term of the asset(s) being hedged (that is, designate the prepayable financial assets or beneficial interest(s) by applying the partial-term guidance in this Update), such that the assumed maturity date of the prepayable financial assets within the closed pool is identical from a hedge accounting perspective. Using the benchmark rate component of the contractual coupon cash flows when (a) all assets have the same assumed maturity and (b) prepayment risk does not affect the measurement of the hedged item results in all hedged items having the same benchmark rate coupon. When those elections are made, and because the portfolio is closed, a similar assets test needs to be performed only at hedge inception. Additionally, all assets in the portfolio for hedge accounting purposes are considered nonamortizing and nonprepayable with the same maturity and coupon, resulting in the similar assets test being performed on a qualitative basis.

BC113. At inception and as part of ongoing effectiveness testing, an entity should complete and document an analysis to support its expectation that the hedged item (that is, the designated last of layer) is anticipated to be outstanding as of the hedged item’s assumed maturity date. This analysis should incorporate the entity’s current expectations of prepayments, defaults, and other events affecting the timing and amount of cash flows associated with the closed portfolio of prepayable financial assets. As long as the hedged item (that is, the designated last of layer) is anticipated to be outstanding as of its assumed maturity date, the hedging relationship can continue and measurement of the hedged item need not incorporate the risks arising from prepayments, defaults, and other factors affecting the timing and amount of cash flows.

BC114. In using the term *outstanding* to describe the balance of the hedged item that is needed to continue hedge accounting without any adjustment to the hedging relationship, the Board had a specific meaning in mind, that is, loans currently held by the entity that are performing (loans that are not delinquent, in default, or had their cash flows affected in any other adverse manner). The Board reinforced this point in paragraphs 815-20-25-12A and 815-25-35-7A by requiring that an entity estimate the balance anticipated to be remaining as of the hedged item’s assumed maturity date net of prepayments, defaults, and other events that affect the timing and amount of cash flows associated with the asset or assets linked to the hedging relationship. Additionally, the Board concluded that determining the balance of the hedged item anticipated to be outstanding is an estimate. As long as a reasonable process exists to support the estimate of the outstanding balance, changes in this

estimate should be considered only on a prospective basis similar to how changes in estimates are considered under current GAAP.

BC115. The Board concluded that an entity need not assert that the assumptions and cash flows used to estimate the balance of the hedged item anticipated to be outstanding as of the hedged item's assumed maturity date align with the probable threshold in the cash flow hedging model. Instead, an entity should have the same level of comfort with the assumptions and cash flows used to support the hedged item being outstanding as the level of comfort with the assumptions and cash flows used for estimating any other point estimate for the respective asset(s), such as a fair value measurement performed in accordance with Topic 820, Fair Value Measurement.

BC116. The Board's primary purpose for incorporating the last-of-layer method into the amendments in this Update is to provide an entity with the ability to obtain hedge accounting for portfolios of prepayable assets without having to incorporate the risks arising from prepayments, defaults, and other factors affecting the timing and amount of cash flows into the measurement of the hedged item.

BC117. The Board considered whether to require within Section 815-25-40, Derivatives and Hedging—Fair Value Hedges—Derecognition, a full dedesignation at the point in time when the analysis required by paragraph 815-25-35-7A indicates that the balance anticipated to be outstanding as of the hedged item's assumed maturity date is less than the hedged item but the current balance of the portfolio is greater than the hedged item. In the Board's view, requiring a full dedesignation would have prevented an entity from following its current policies and practices on partial dedesignation. Therefore, the Board added the guidance in paragraph 815-25-40-8(a).

BC118. If on any subsequent effectiveness testing date an entity determines that the outstanding amount of the closed portfolio as of the reporting date is less than the hedged item (that is, the designated last of layer), the hedging relationship must be discontinued immediately (as discussed in paragraph 815-25-40-8(b)). Because the process of forecasting the hedged item was unsuccessful, the Board concluded that the entity should not be afforded the flexibility of partial dedesignations.

BC119. The Board acknowledges that estimating the balance expected to be remaining at the hedged item's assumed maturity date resembles a cash flow hedging concept. However, the Board concluded that other aspects of the cash flow hedging model need not be incorporated into the last-of-layer method. The Board concluded that, in addition to the probable threshold discussed in paragraph BC115, the tainting threshold in paragraph 815-30-40-5 should not be incorporated into this method.

BC120. Throughout the life of the hedging relationship, the basis of the hedged item needs to be adjusted for changes in interest rate risk. The Board observes that there are currently areas of GAAP for financial instruments that require

portfolio level adjustments with no guidance on how those amounts should be allocated to the items within the portfolio. There also are other areas of GAAP for financial instruments in which the Board acknowledges that there are various methods of allocating adjustments to individual assets. Therefore, the Board did not prescribe a specific method.

BC121. Stakeholders questioned how adjustments to the carrying value of the asset or assets linked to a hedging relationship designated under the last-of-layer method would interact with other areas of GAAP. The Board concluded that basis adjustments need not be allocated to outstanding last-of-layer method hedging relationships for subsequent measurement purposes for the following reasons:

- a. Basis adjustments for this type of hedging relationship relate directly to the hedged item (that is, the designated last of layer), not the assets that make up the closed portfolio. If an asset is sold from the closed portfolio and the remaining balance of the portfolio exceeds the last of layer designated as the hedged item, a portion of the remaining basis adjustment does not need to be allocated to the asset that was sold. It should be clear that the asset sold relates to the portion of the portfolio that exceeds the hedged item (that is, the designated last of layer).
- b. If basis adjustments are allocated to individual assets during the life of a hedging relationship, it may result in financial reporting outcomes that are inconsistent with the risk management activities that are undertaken. For example, if an entity elects to allocate basis adjustments for this type of hedging relationship to individual assets and the assets are sold or prepaid during a subsequent period, it may result in noneconomic gains or losses on extinguishment because of hedge accounting adjustments that would have naturally reversed over the life of the hedging relationship.
- c. If the last-of-layer method hedging relationship is outstanding at the end of the period, the entity would have already completed an analysis to comply with the requirements of this method that supports that the basis adjustment associated with the hedged item is not affected by expected prepayments, defaults, and other factors affecting the timing and amount of cash flows.

BC122. The Board acknowledges that an allocation process may be needed to comply with certain disclosure requirements for an asset class. Therefore, paragraph 815-10-50-5B was added to the Codification for those purposes. This paragraph allows the basis adjustment to be allocated to individual assets or any other level more granular than the entire portfolio and less granular than the individual asset, which is described as an allocation at a portfolio level.

BC123. Additionally, the Board does not consider it necessary to provide specific guidance on how an entity should implement the guidance in this Update in relation to estimating credit losses or any other requirement in GAAP. The Board believes that the interaction of two or more areas of GAAP is an operational process unique

to every entity based on its systems, policies, and facts specific to its circumstances. Therefore, entities should have flexibility in determining how to operationalize the interaction between multiple areas of GAAP in a manner that is appropriate for its specific facts and circumstances.

BC124. Some stakeholders questioned whether the approach could be equally applicable to investments in a mortgage-backed security in which the collateral for the security is a portfolio of prepayable loans. The Board decided that the approach could apply to a mortgage-backed security, any other beneficial interest, or a portfolio of beneficial interests collateralized by prepayable financial instruments. The Board concluded that applying the approach to those asset-backed securities is reasonable because the cash flows paid or received on a beneficial interest are generated from a portfolio of financial instruments. Although the unit of account is different, the substance of a beneficial interest's cash flows is economically identical to that of a pool of prepayable financial assets.

BC125. The Board considered whether to add to Topic 815 an explicit restriction from using the shortcut method to assess effectiveness when the hedged item is designated under the last-of-layer method. The Board ultimately concluded that the current criteria for applying the shortcut method clearly prohibit its application when the hedged item is designated under this method. Specifically, paragraph 815-20-25-105(e) requires that all the assets in the portfolio comply with the shortcut hedging criteria. Because the assets are prepayable, they do not comply with the shortcut criteria in paragraph 815-20-25-104(e).

BC126. Although the guidance related to this approach in Topic 815 specifically applies to assets, stakeholders questioned whether the approach could be applied equally to liabilities. However, comment letter respondents focused on addressing the issue of hedging assets that are prepayable at any time after issuance. The Board received minimal feedback during the comment letter process on hedging the interest rate risk in liabilities that are prepayable any time after issuance. When the Board approved the last-of-layer method, one of the factors that led to its decision was the high amount of uncertainty about the determination of which prepayable assets would prepay. This uncertainty is primarily due to the prepayment option being controlled by the borrower (in the case of prepayable assets, the entity looking to hedge is the investor or creditor, not the borrower). In the case of prepayable liabilities, the level of uncertainty about prepayments is diminished by the prepayment option being controlled by the entity that wants to hedge the interest rate risk. In light of those factors and concerns about unintended consequences, the Board did not extend the scope of the last-of-layer method to liabilities.

Measuring the Hedged Item Similarly for Similar Hedging Relationships

BC127. The Board considered whether an entity's decisions on how to designate and measure the hedged item should be applied consistently for hedging

relationships considered similar in accordance with paragraph 815-20-25-81. When making this determination, the Board considered the conclusions it reached in Accounting Standards Update No. 2013-10, *Derivatives and Hedging (Topic 815): Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes*. In that Update, the Board superseded the guidance in paragraph 815-20-25-6 that required an entity to use the same benchmark rate for similar hedging relationships.

BC128. As a result of that decision, determining which benchmark rate to designate in the hedged item could be made on a hedge-by-hedge basis. The basis for conclusions of that Update indicates that risk managers may have valid reasons to hedge using different benchmark rates. For example, interest rate risk may differ for similar financial assets and liabilities based on how that hedged item is used in the organization and the risk manager's objective in hedging its respective interest rate.

BC129. At the time that decision was made, no elections could be made when measuring the hedged item in a fair value hedge of interest rate risk. That is, the hedged item's measurement had to be based on its entire coupon, entire term, and all embedded risks (such as prepayment or credit risk). Given the logic supporting the Board's rationale for removing the similar hedges guidance from paragraph 815-20-25-6, the Board concluded that the elections permitted by the amendments in this Update for determining how to designate and measure the hedged item should be allowed on a hedge-by-hedge basis as well.

Income Statement Presentation of the Change in the Fair Value of Hedging Instruments

BC130. For fair value, cash flow, and net investment hedges, the Board concluded that the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness should be presented in the same income statement line that is used to present the earnings effect of the hedged item. For fair value and cash flow hedges, the Board also concluded that when recognized in earnings, excluded components should be presented in the same income statement line item in which the earnings effect of the hedged item is presented.

BC131. However, for net investment hedges, the Board decided to retain current GAAP and not prescribe presentation of excluded components because presenting those amounts together with the earnings effect of the hedged item in a net investment hedge could result in presentation in a line item such as "gain or loss on the sale of subsidiary." However, the sale or liquidation of a subsidiary may not have occurred in the current period, may not occur within a reasonable time period, or may not occur at all. Mandating this presentation would not have improved financial reporting.

BC132. The Board decided that in determining the appropriate income statement line item(s) to present the change in fair value of the hedging instrument, an entity should follow the income statement presentation of the earnings effect of the hedged item before applying hedge accounting. The Board notes that in some cases, this income statement presentation approach will result in all changes in fair value of the hedging instrument included in a single income statement line item, while in other cases it will result in changes in fair value of the hedging instrument included in more than one income statement line item (as illustrated in paragraph BC134).

BC133. For example, if a hedging relationship involves only the interest rate risk in an interest-earning asset or interest-bearing liability (carried at amortized cost), the earnings effect before applying hedge accounting typically is presented in an interest income or interest expense line item. The Board believes this type of hedging relationship should result in all changes in fair value of the hedging instrument included in the interest income or interest expense line item. The Board understands that this could result in a change in practice for some entities such that both interest accruals and other changes in fair value of the hedging instrument will be recognized in interest income or interest expense rather than in separate income statement line items.

BC134. In another example, if a hedging relationship involves hedging both the interest rate risk and the foreign currency risk of an interest-earning asset or interest-bearing liability (carried at amortized cost) denominated in a currency other than an entity's functional currency, the earnings effect of the hedged item before applying hedge accounting typically is presented in both an interest income or interest expense line item and another line item that the entity uses to present the spot remeasurement of its foreign-currency-denominated assets and liabilities under Topic 830. For this type of hedging relationship in which an entity recognizes the earnings effect of the hedged item in two income statement line items, the Board concluded that it is appropriate also to present the changes in fair value of the hedging instrument in those same two income statement line items. The portion of the hedging instrument associated with converting the interest cash flows from fixed-rate to floating-rate and/or from a foreign currency to the entity's functional currency should be presented in interest income or interest expense except for the portion that the entity determines should be presented in the income statement line item used to present the remeasurement of foreign-currency-denominated assets and liabilities.

BC135. The Board received differing feedback on these presentation requirements from financial institution and nonfinancial institution stakeholders. Nonfinancial institution stakeholders considered the requirements reasonable because in some nonfinancial industries hedging results already are presented in this manner. However, financial institution stakeholders expressed concern about the requirements because of their potential for generating incremental volatility in net interest income, as highlighted by the two preceding examples.

BC136. During redeliberations, the Board affirmed this income statement presentation approach based on the same view that resulted in it deciding on this approach during initial deliberations. That is, if an entity enters into a hedging instrument, all effects of that hedging instrument (that is, the effective and the ineffective portions and amounts excluded from the assessment of effectiveness) should be presented together with the earnings effect of the hedged item. The Board concluded that this income statement presentation approach better reflects the results of hedge accounting and provides financial statement users with more decision-useful information. Additionally, certain Board members believe that all the effects of the hedging instrument are costs of the hedging program and that all costs should be presented in the same income statement line item as the earnings effect of the hedged item.

BC137. When making its final determination during redeliberations, the Board considered paragraph PR37 of the 2016 Exposure Draft, *Conceptual Framework for Financial Reporting: Chapter 7: Presentation*, which reflects its current conceptual views on presentation. This paragraph specifies certain factors to consider when determining the line item in comprehensive income in which an individual transaction should be recorded. Item (b) in that paragraph states that the comprehensive income line item should consider the activity with which an item is associated. Because hedge accounting is elective, the Board believes this factor (that is, “the activity”) is determinative because it supports the view that the aggregate results of hedging activities (that is, income statement effects for the hedged item and hedging instrument) should be presented together.

BC138. The Board opposed retaining the view under current GAAP that an entity should have a choice about the income statement presentation of the effective and ineffective portions of the change in the fair value of the hedging instrument. The Board understands that under current practice entities commonly present the effective portion and the ineffective portion, as well as any excluded components, in different income statement line items. The Board concluded that including all effects of a hedging instrument in the same income statement line item used to present the earnings effect of the hedged item makes the effect of entering into the hedging strategy more transparent.

BC139. The Board also considered whether the presentation requirements should apply to cash flow hedges in which a hedged forecasted transaction is later determined to be probable of not occurring (missed forecast). Current GAAP requires an entity to immediately reclassify amounts from accumulated other comprehensive income to earnings without specificity to presentation. The amendments in the proposed Update would have required that changes in the fair value of the derivative be reclassified from accumulated other comprehensive income to earnings in the income statement line in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred. The Board believed that the hedging instrument is part of the entity’s overall hedging program. Therefore, it is irrelevant if the hedged forecasted transaction occurred or not.

BC140. In the feedback received from stakeholders, both preparers and users emphasized that such presentation would not provide decision-useful information because of the potentially distortive effects on individual income statement line items. In a missed forecast, only the earnings effect of the hedging instrument would have been recorded in the line item intended to be hedged, but there would have been no offsetting earnings effect from a hedged item. For example, in a missed forecasted sales transaction, an entity would record the change in the fair value of the hedging instrument in revenue, but there would be no corresponding revenue from the sale. The Board concluded that financial reporting would not be improved by requiring that the gain or loss of the hedging instrument that had been deferred in accumulated other comprehensive income be recorded in a line item in which there is no offset from the hedged item. Therefore, the Board decided to retain current GAAP by not providing specific presentation guidance for missed forecasts.

Recognizing the Change in the Fair Value of Hedging Instruments Included in the Assessment of Hedge Effectiveness

BC141. For cash flow and net investment hedges, the Board decided that changes in the fair value of a hedging instrument no longer should be split into effective and ineffective portions and that the entire change in the fair value of the hedging instrument included in the assessment of effectiveness should be recognized when the hedged item affects earnings. This approach differs from the requirements under current GAAP in which only the effective portion of the change in the fair value of the hedging instrument is accorded hedge accounting (that is, deferred in other comprehensive income for cash flow and net investment hedges and reclassified to earnings when the hedged item or net investment affects earnings). These decisions better reflect an entity's risk management activities.

BC142. The Board agreed with many stakeholders that maintained that the concept of hedge ineffectiveness is confusing and that the timing of recognizing ineffectiveness in the financial statements under current GAAP does not provide them with useful information. The Board also opposes the view under current GAAP that the ineffective portion of the change in the fair value of the hedging instrument should be treated like any other nonhedging derivative under Topic 815 (that is, recorded in current-period earnings). The Board concluded that doing so makes the effect of entering into the hedging strategy less transparent by presenting the effective and ineffective portions of the hedging instrument potentially in different financial reporting periods.

BC143. The Board decided to eliminate the term *ineffectiveness* from the amendments in this Update because the effective and the ineffective portions of a hedging instrument no longer are separately recognized. However, the Board also acknowledges that although the term is eliminated from GAAP, it does not mean

that all hedges are considered perfectly effective. Under a highly effective threshold to qualify for hedge accounting, there still could be mismatches between the change in the fair value of the hedging instrument and the change in the fair value or cash flows of the hedged item attributable to the hedged risk that affect earnings.

BC144. The Board also concluded that eliminating the requirement to separately calculate and disclose the amount of hedge ineffectiveness will reduce costs and administrative burden while providing users of financial statements with greater transparency about the effect of hedge accounting on an entity's financial statements.

BC145. The Board acknowledges that its decision to no longer permit an entity to split the change in the fair value of a qualifying hedging instrument into effective and ineffective portions has several other implications. Relative to current GAAP, there could be a change in the timing of the recognition of the ineffective portion of the hedging instrument for cash flow overhedges (that is, when the cumulative change in the fair value of the actual hedging derivative is greater than the cumulative change in the fair value of the perfect hypothetical hedging derivative). Those amounts no longer are recognized currently in earnings but rather are deferred in other comprehensive income until the hedged item affects earnings. However, there is no change to GAAP for cash flow underhedges (that is, when the cumulative change in the fair value of the actual hedging derivative is less than the cumulative change in the fair value of the perfect hypothetical hedging derivative) because ineffectiveness for cash flow underhedges is not recognized under current GAAP. For fair value hedges, the Board observes that there is no change to the timing of the recognition of the ineffective portion of the hedge. Additionally, although there are changes to the timing of the recognition of the ineffective portion of a hedging instrument in a cash flow hedging relationship, the Board observes that the requirement in current GAAP regarding a highly effective threshold remains.

BC146. For net investment hedges, the amendments in this Update eliminate the recognition of ineffectiveness for net investment overhedges and underhedges. The entity will record the change in the fair value of an actual hedging instrument, not the change in the fair value of the perfect hypothetical hedging instrument as is currently required.

Non-Zero Fair Value of Hedging Derivative at Hedge Inception

BC147. When the Board decided to eliminate the separate measurement of hedge ineffectiveness for cash flow hedges, it also was informed that there may be indirect consequences of this decision that need to be addressed related to hedging instruments that have a non-zero fair value at hedge inception.

BC148. For hedging instruments with a single cash flow (such as a forward or option contract), the Board concluded that no additional guidance is needed

because the cumulative change in fair value of the derivative deferred in other comprehensive income is released to the income statement when the hedged item matures regardless of whether the value of the hedging instrument at hedge inception is zero or other than zero.

BC149. For hedging instruments with multiple cash flows or periodic cash settlements (such as swaps or caps), the valuation mechanics of those instruments necessitates additional guidance. The Board is aware that under current practice an entity records the periodic cash settlement in earnings, while the change in value of all future periodic settlements, commonly referred to as the “clean value,” is deferred in other comprehensive income. Additionally, the Board also is aware that at maturity there are no future cash settlements on the instrument; therefore, its clean value always will be zero. If the clean value of the hedging instrument is not zero at hedge inception and the clean value of the hedging instrument is zero at its maturity, then the mechanics that an entity follows under current practice would result in the initial fair value or some portion of the initial value of the hedging instrument remaining in accumulated other comprehensive income when the hedging instrument matures.

BC150. Under current GAAP, the initial value is recorded in earnings throughout the life of the hedging relationship as the hedged cash flows occur and ineffectiveness is recognized. However, because the measurement of ineffectiveness is removed from the guidance, the Board concluded that additional guidance is needed to ensure that those amounts are cleared from accumulated other comprehensive income at the maturity of the hedging relationship.

BC151. Stakeholders informed the Board that there are multiple methods to mechanically ensure that the initial value or some portion of the initial fair value of the hedging instrument does not remain in accumulated other comprehensive income at the end of the hedging relationship. Because of the various alternatives that can be employed, the Board did not want to endorse a single method. Therefore, it concluded that the guidance in paragraph 815-30-35-41A should simply require that amounts related to the initial fair value be amortized to earnings on a systematic and rational basis.

Recognizing the Change in the Fair Value of Hedging Instruments Excluded from the Assessment of Hedge Effectiveness

BC152. Topic 815 permits an entity to exclude option time value (or portions of option time value) and forward points from the assessment of hedge effectiveness and the measurement of ineffectiveness (excluded components). If an entity elects to exclude those components, their changes in value must be recognized currently in earnings. Topic 815 is silent on income statement presentation of excluded components.

Recognition Model for Excluded Components

BC153. For fair value and cash flow hedges, the amendments in this Update require presentation of changes in fair value of excluded components in the same income statement line item as the earnings effect of the hedged item. The Board received mixed feedback from stakeholders on this approach in the proposed Update. Many stakeholders preferred having no specific guidance on presentation because they view an excluded component as excluded from the hedging relationship entirely. However, several stakeholders expressed the view that the presentation requirement is not the issue. Rather, those stakeholders argued that the mark-to-market recognition approach in GAAP retained by the proposed Update does not reflect the economics of the excluded component when its fair value always deteriorates to zero. Furthermore, those stakeholders argued that the decision on presentation implies that the excluded component is part of the hedging relationship. Therefore, a recognition approach that better reflects the economic cost of the excluded component would be appropriate.

BC154. Based on that feedback, the Board considered a recognition model for amounts excluded from fair value and cash flow hedge relationships in which (a) the initial value of the component excluded from the assessment of effectiveness is recognized in earnings using a systematic and rational method over the life of the hedging instrument and (b) any difference between the change in fair value of the excluded component and amounts recognized in earnings under that systematic and rational method is recognized in other comprehensive income (amortization approach). Under this amortization approach, the excluded component is viewed as a fixed cost that should be expensed over time, akin to an insurance premium. The stakeholders supporting this approach engage in hedging strategies in which the hedging instrument is often held to maturity, in which case the amortization approach would reflect the deterioration of the excluded component to zero by maturity of the derivative. For those stakeholders, this amortization approach better reflects the economics of the hedging instrument and aligns with how they view the derivative from a risk management perspective.

BC155. Other stakeholders stated that recognizing changes in fair value of the excluded component currently in earnings is more aligned with the economics of the hedging instrument, particularly when hedging strategies are employed in which entities frequently dedesignate and redesignate hedging relationships. Those stakeholders noted that significant operational complexity would arise under an amortization approach in these types of hedging strategies. They also observed that there may be a “mixed measurement” model when an entity discontinues a hedging relationship such that the entity recognizes the excluded component on a systematic and rational basis when it is designated in a hedging relationship and then through a mark-to-market approach once it is discontinued.

BC156. The Board considered this feedback and decided to retain its decision from initial deliberations on presentation but to reconsider the recognition model

for excluded components to respond to stakeholders' feedback and to better align the accounting for excluded components with how they are viewed from a risk management perspective. The Board ultimately made the following changes to the recognition model for excluded components in fair value and cash flow hedges:

- a. The initial value of an excluded component is recognized in earnings using a systematic and rational method over the life of the hedging instrument, and any difference between the change in fair value of the excluded component and amounts recognized in earnings under the systematic and rational method are recognized in other comprehensive income.
- b. An entity also may elect to recognize changes in fair value of an excluded component currently in earnings. That election is required to be applied consistently to all similar hedging relationships and disclosed as an accounting policy election.
- c. Under either of these recognition approaches, amounts related to excluded components that are recorded in earnings are presented in the same income statement line item as the earnings effect of the hedged item.

BC157. The Board acknowledges the different perspectives on the overall recognition approach for excluded components, which are driven by fundamentally different risk management strategies. The Board decided that to meet the project's overall objective to better portray the economic results of an entity's risk management activities, allowing either an amortization approach or a mark-to-market approach is appropriate. The Board views excluded components as being part of the hedging relationship rather than as being a separate freestanding derivative. Therefore, the Board concluded that the base model for recognizing changes in value of excluded components should be an amortization approach as described in paragraph BC154. However, the Board decided that entities also should be permitted to elect a mark-to-market approach as described in paragraph BC155. That election must be applied consistently to all similar types of hedging relationships.

BC158. After the Board proposed allowing an amortization approach for cash flow and fair value hedges, the Board received feedback that although there is no prescribed presentation guidance for excluded components in net investment hedges, an amortization approach would be beneficial. Stakeholders noted that there are some net investment hedging strategies that entities would like to employ but currently do not because those strategies would result in financial reporting outcomes that are inconsistent with the economics of the risk management activity. Therefore, the Board decided to extend the amortization approach to net investment hedges so that the accounting better reflects an entity's risk management activities.

BC159. The Board also considered how changes in fair value of an excluded component recorded in accumulated other comprehensive income (or for net

investment hedges, the cumulative translation adjustment section of other comprehensive income) should be accounted for upon dedesignation of the hedging relationship. The Board concluded that those amounts should be recognized in earnings consistent with how amounts are recognized in earnings for discontinued fair value, cash flow, and net investment hedges. The Board notes that this approach avoids immediate releases to earnings of amounts in accumulated other comprehensive income (or, for net investment hedges, the cumulative translation adjustment section of accumulated other comprehensive income) upon a dedesignation. Additionally, it is more operable because entities already are familiar with the existing guidance for the discontinuation of hedging relationships. The Board also observed that if a net investment hedge is discontinued, the difference between the change in the fair value of the excluded component and the amounts recognized in earnings under an amortization approach recorded in the cumulative translation adjustment section of other comprehensive income will remain there until the foreign operation is sold or liquidated.

BC160. The Board also considered an alternative that would have required an entity to amortize the initial value of the excluded component over the life of the hedged item (or for a forecasted transaction, between the hedge designation date and the date on which the forecasted transaction affects earnings). The Board acknowledged that under that approach a change in the timing of the hedged forecasted transaction would have resulted in a change in the amortization pattern for the excluded component. Stakeholders stated that changes in the amortization pattern may be complex to operationalize given the large volume of transactions for which the timing of the hedged forecasted transaction is subject to change. The Board ultimately rejected this alternative and chose the amortization period of the excluded component to be over the life of the hedging instrument because that timing does not change, which makes the model more operable.

Cross-Currency Basis Spreads as Excluded Components

BC161. Stakeholders indicated that the accounting for currency swaps in a fair value hedge under GAAP often results in significant ineffectiveness and income statement volatility because of the associated cross-currency basis spreads. Furthermore, some stakeholders noted that they do not currently utilize currency swaps because of the potential for income statement volatility, even though those instruments may be the best risk management tool that is available.

BC162. The Board notes that, similar to forward points, cross-currency basis spreads always deteriorate to zero by the time the derivative matures. Additionally, the volatility generated by cross-currency basis spreads is because practice includes them in the measurement of the hedging instrument, but not the measurement of the hedged item. The Board decided to allow the change in fair value of cross-currency basis spreads in currency swaps to be excluded from the assessment of effectiveness for the reasons mentioned in this paragraph. When

combined with a recognition approach that allows the initial value of an excluded component to be recognized on a systematic and rational basis, this decision better aligns the accounting for currency swaps with an entity's risk management activities.

BC163. Through outreach, the Board understands that the initial cost of a cross-currency basis spread is embedded in the coupon payments that an entity has agreed to pay to the bank counterparty. Consequently, the initial cost of the cross-currency basis spread is recorded in earnings each period through the typical swap accrual process. In the Board's view, recognizing the cross-currency basis spread in earnings through the swap accrual is a systematic and rational method for recognizing the cost of the cross-currency basis spread in earnings.

BC164. Therefore, when an entity elects to consider a cross-currency basis spread as an excluded component that is recognized in earnings on a systematic and rational basis, the change in fair value of the swap attributable to the cross-currency basis spread incorporated in the discount rates used to value the swap is deferred in other comprehensive income. No amounts related to the change in value of the cross-currency basis spread (via their effect on discounting the remaining swap cash flows) need to be manually amortized to earnings because their effect on the swap discounting reverses to zero in accumulated other comprehensive income as the swap matures.

Effectiveness Threshold

BC165. To qualify for hedge accounting under current GAAP, the relationship between a hedging instrument and a hedged item must be *highly effective* in achieving offsetting changes in fair value or cash flows attributable to the hedged risk. Topic 815 does not define *highly effective*, but practice has interpreted it to be an 80–125 percent offset between the changes in the fair value of the hedging instrument and the changes in the fair value or cash flows of the hedged item or transaction attributable to the hedged risk.

BC166. In both the 2008 and the 2010 Exposure Drafts, the Board proposed amending the hedge effectiveness guidance such that it no longer would have required a hedging relationship to be highly effective to qualify for hedge accounting. Instead, the Board proposed that the qualifying criteria for designating a hedging relationship would have been that the hedge is *reasonably effective* at offsetting changes in fair values or cash flows attributable to the hedged risks during the period of the hedging relationship. The term *reasonably effective* was intended to be principles-based and, therefore, the Board would not have numerically defined a range about what was meant by *reasonably effective*. In deliberations leading to this Update, the Board again considered replacing a highly effective threshold with a reasonably effective threshold.

BC167. Nonuser stakeholders who responded to the 2010 Exposure Draft and participated in subsequent outreach generally supported the proposed

effectiveness requirements in principle. However, there were concerns that the term *reasonably effective* was unclear, and would potentially create diversity in practice. Additionally, although the reasonably effective threshold was intended to be qualitative in nature, there was concern that practice would simply revert to a quantitative measure in order for it to be operable.

BC168. Based on that feedback, the Board considered two potential alternatives in initial deliberations for further developing the reasonably effective threshold. The first alternative would have defined a numerical threshold (for example, 50–200 percent or 60–167 percent). Through outreach and research, however, a lower threshold that would be sufficiently grounded in statistical theory was unable to be found. Therefore, any choice made by the Board to define a new numerical threshold would have been arbitrary.

BC169. The second alternative that the Board considered would have involved developing qualitative indicators to determine whether a hedging relationship meets a reasonably effective threshold. Those could have been based on less stringent versions of the criteria for the shortcut and critical terms match methods, such as aligning the notional amounts of the derivative and the hedged item designated as being hedged; the underlying risks hedged and the hedging instrument (for example, interest rates, other indexes, and locations or currencies referenced in the hedged item and the hedging instrument); maturity dates, payment dates, reset dates, and other dates; and other substantive features of the hedged item and hedging instrument. The Board concluded that a list of indicators would have only shifted the judgment and lack of clarity from what reasonably effective means to what the indicators mean. Therefore, if the Board would have adopted a reasonably effective threshold, it felt that it would have had to define a numerical threshold.

BC170. Ultimately, the Board decided to retain the highly effective threshold of Topic 815. The Board acknowledges that outreach participants generally supported a reasonably effective threshold and the higher levels of ineffectiveness that could be recorded under that threshold as a way to expand the applicability of the hedge accounting model even though they do not manage risks in that manner. Rather than changing the effectiveness threshold, most stakeholders preferred a hedge accounting model that mirrors how they manage risks, that is, by hedging “component” risks such as interest rate risk, foreign exchange risk, or commodity price risk with derivatives that closely or perfectly match those risks. Those stakeholders noted that if component hedging were expanded, the highly effective threshold could be retained.

BC171. The Board also considered, but rejected, a specialized nonfinancial cash flow hedging model based on a reasonably effective threshold. Under that model, if the change in the fair value of the hedging instrument and the change in the *total price* of the hedged item meet a reasonably effective threshold, an entity would have:

- a. Recorded the entire change in fair value of the hedging derivative in other comprehensive income
- b. Recorded no ineffectiveness during the life of the hedge
- c. Reclassified to earnings amounts deferred in accumulated other comprehensive income when the hedged item affects earnings and present those amounts in the same income statement line item in which the earnings effect of the hedged item was presented (for example, cost of goods sold).

BC172. Although this proposed model is not technically a component hedging model, its effect is similar to that of component hedging for primary or major components of a nonfinancial asset without having to be concerned if that component is contractually specified or not. The component of the nonfinancial asset would have to be fairly significant for the change in the fair value of the hedging instrument and the change in price of the entire hedged item to meet a reasonably effective threshold (for example, 50–200 percent or 60–167 percent).

BC173. The Board also rejected this proposed model because it would not have reflected that entities manage commodity price risk on a component basis. In addition, the Board did not want to increase the complexity of hedge accounting by introducing a unique hedge accounting model with a reasonably effective threshold for hedges of nonfinancial assets while retaining a highly effective threshold for hedges of financial instruments. However, the Board decided to carry forward the financial statement presentation aspect of this model (discussed in paragraph BC171(c)) to all hedging relationships.

Time to Complete Initial Quantitative Prospective Effectiveness Assessment

BC174. The Board concluded that an entity may perform the initial prospective quantitative assessment of hedge effectiveness at any time after hedge designation but no later than the first quarterly effectiveness testing period. The timing requirement for preparing all other hedge documentation is unchanged. The Board views this as simplifying hedge documentation requirements in Topic 815. The Board also decided to provide additional hedge documentation relief to private companies that are not financial institutions and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market). See the discussion beginning in paragraph BC178.

BC175. Based on outreach, stakeholders generally supported providing some relief regarding hedge documentation while maintaining the rigor of the hedge accounting model. For some entities, completing the quantitative testing portion of hedge documentation concurrent with hedge designation is onerous. Outreach participants suggested that entities should have more time to complete this initial testing. They maintained that as long as all other hedge documentation is in place at hedge inception, such as identifying the hedged item, the hedged risk, the hedging instrument, and the method of assessing hedge effectiveness, an entity could not retroactively designate or dedesignate a hedging relationship to achieve a desired accounting result. Regardless of the date the quantitative testing is performed, the data used to perform the test must be as of the date of hedge inception.

BC176. The Board decided to provide an entity with as much as three months to perform initial quantitative effectiveness tests. The Board views this as similar to the time frame required for the assessment of effectiveness, which is required to be performed when financial statements or earnings are reported and at least every three months. The Board observes that there may be scenarios in which an entity may have to perform the initial quantitative assessment of hedge effectiveness earlier than the date on which hedge effectiveness assessments are performed, such as before the dedesignation of a hedge; the date of expiration, sale, termination, or exercise of the hedging instrument; or the occurrence of a forecasted transaction for the purchase or sale of a nonfinancial asset. The Board concluded that an entity should have all the results of the effectiveness testing and financial statement effect of a hedging relationship before the hedging relationship ends.

BC177. This decision may not provide relief for entities that have a significant volume of hedging relationships or for entities that frequently designate and dedesignate hedging relationships because those entities usually have systems and processes in place that are capable of complying with the concurrent documentation and effectiveness requirements. However, the Board concluded that its decision may provide relief for entities with limited hedging activity.

Timing of Hedge Documentation for Certain Private Companies and Not-for-Profit Entities

BC178. The Board decided to provide additional relief on the timing of hedge documentation for private companies that are not financial institutions as described in paragraph 942-320-50-1 and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market). Many private company stakeholders stated that they lack the resources to complete the required hedge documentation and initial and subsequent effectiveness assessments in a timely manner. In addition, many private companies do not have quarterly reporting requirements. The Board received similar feedback from not-

for-profit entity stakeholders. Therefore, granting up to three months after hedge designation to prepare the initial quantitative effectiveness assessment does not align hedge effectiveness testing requirements with the reporting cycle of a private company or a not-for-profit entity as it does for a public business entity.

BC179. Entities within the scope of this decision are required to document only the hedging instrument, the hedged item or transaction, and the nature of the risk being hedged concurrently at hedge inception. The Board concluded that sound risk management practices support evidence of those items being considered and documented concurrent with derivative execution.

BC180. Performance and documentation of all initial and subsequent hedge effectiveness assessments (either on a quantitative or qualitative basis) may be deferred until the next interim (if applicable) or annual financial statements are available to be issued.

BC181. The Board acknowledges that some private companies and not-for-profit entities have interim reporting requirements. Therefore, all relevant documentation and effectiveness assessments must be completed before the next interim or annual GAAP financial statements (including footnotes) are available to be issued after hedge inception.

BC182. The method that will be used to assess effectiveness is not required to be documented at hedge inception and may be deferred until the date on which the initial assessment of effectiveness is performed. The Board concluded that this should result in additional cost savings for private companies and that the risk of a private company choosing an assessment method to obtain a desired accounting result is relatively minimal.

BC183. The Board notes that its decisions have no effect on the hedge documentation requirements provided under the simplified hedge accounting approach for private companies that are not financial institutions. Those companies still have up to the time that the first annual financial statements are available to be issued after hedge inception to prepare *all* hedge documentation for the hedging strategy that qualifies under that approach.

BC184. The Board notes that Statement 133's original intent was for hedge effectiveness to be continuously monitored on an ongoing basis. However, that guidance only required formal effectiveness testing every three months to make the model more operable. The Board concluded that allowing entities within the scope of this decision more time to prepare the initial and subsequent effectiveness assessments more closely mirrors these entities' reporting cycles and is consistent with the concept of allowing more time for operational reasons in Statement 133. However, the Board decided not to reduce the minimum frequency of effectiveness assessments (that is, quarterly) that must be performed. The simplification in the amendments in this Update only amends the timing of the performance of those assessments. The Board concluded that if an entity only assesses effectiveness once before annual financial statements are available to

be issued and the effectiveness test shows the hedge not to be highly effective, it may be more difficult to determine when a hedge ceased to be highly effective during the reporting period than if it had been monitoring the hedging relationship by performing assessment of effectiveness on a quarterly basis. The Board decided to exclude private companies that are financial institutions from this additional documentation relief and, instead, decided to require the same timing of hedge documentation preparation that is required for public business entities. In reaching that decision, the Board notes that even if a financial institution meets the definition of a private company, it typically is subject to quarterly regulatory reporting in which the amounts reported are based on GAAP. In addition, financial institutions generally have adequate resources to comply with Topic 815 and have greater exposure to financial instruments because they are more relevant to their business. The Board used the same rationale for excluding those entities from the simplified hedge accounting approach for private companies.

BC185. The Board also decided to add a documentation example to Topic 815 for a hedging relationship that uses the critical terms match method to assess effectiveness. This example should assist private companies and other entities in better understanding the scope and content of the information that must be included in hedge documentation.

BC186. The Board considered, but rejected, an alternative that would have allowed a private company to prepare *all* hedge documentation before annual financial statements are available to be issued. The Board rejected this alternative because it was concerned that if a private company could defer all initial hedge documentation such as the hedged item, hedging instrument, and the nature of the hedging relationship, it could retroactively designate (or not designate) a derivative in a hedging relationship to achieve a desired outcome. The Board also rejected an alternative in which a private company could have made an accounting policy election to require it to apply hedge accounting to any freestanding derivative that it executed. However, the Board notes that a private company can make this accounting policy election under current GAAP without any additional standard-setting activity by the Board.

BC187. The Board also considered combining into a single principle its two decisions on the timing of hedge documentation preparation for both (a) public business entities and private companies that are financial institutions and (b) entities that are neither public business entities nor private companies that are financial institutions. Specifically, under that potential approach, all entities would have had until interim (if applicable) or annual financial statements are available to be issued to complete initial and subsequent hedge effectiveness assessments. However, the Board notes that that approach could have had unintended consequences, such as changing the required timing of hedge effectiveness assessments for public business entities that do not issue interim financial statements (for example, public business entities that are not Securities and Exchange Commission filers). Therefore, the Board acknowledges that timing

relief for private companies and not-for-profit entities must be an exception to the general timing requirements.

Amendments to the Shortcut and Critical Terms Match Methods

BC188. Current GAAP contains specialized methods of hedge accounting known as the shortcut method and the critical terms match method, which allow an entity to qualitatively assume, in very limited circumstances, that a hedging relationship is highly effective and that there is no ineffectiveness to be recognized or measured. Both the 2008 and the 2010 Exposure Drafts proposed eliminating those methods for several reasons. Those methods were viewed as having limited utility given proposals to reduce the effectiveness threshold for hedge accounting and to require a primarily qualitative approach for assessing hedge effectiveness. Additionally, some entities encountered difficulties in complying with the strict criteria in the shortcut and critical terms match methods. Numerous practice problems and incorrect use of the shortcut method also resulted in restatements.

BC189. In deliberations leading to this Update, the Board decided to retain the shortcut and critical terms match methods. On the basis of stakeholders' feedback received in response to the 2010 Exposure Draft and in outreach performed in connection with this Update, the Board understands that many medium- and small-sized public entities as well as private entities rely on the simplification that those methods provide. The Board also understands that those methods are cost-effective for entities that do not have the resources to employ a quantitative method to assess effectiveness. Stakeholders noted and the Board agrees that eliminating the shortcut and critical terms match methods would have increased costs for preparers and would have resulted in very little benefit to users because the earnings mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction attributable to the hedged risk generally will be insignificant. When the Board decided to retain the shortcut and critical terms match methods, it also agreed that it should address stakeholders' certain practical concerns about these methods of assessing effectiveness.

Shortcut Method

BC190. To address the restatements that had resulted from the application issues associated with the shortcut method in practice, the Board decided to ease application in instances in which an entity determines that the shortcut method should not have been applied, but the hedging relationship was and remains highly effective. Specifically, the Board concluded that when an entity elects to apply the shortcut method, if at some point during the life of the hedging relationship the

entity determines that use of the method was not or no longer is appropriate, it may apply a long-haul method of accounting if all of the following conditions are met:

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

BC191. The Board considered two scenarios in which the shortcut method would not be applicable at a date after hedge inception.

- a. An entity did not meet the shortcut method criteria at inception of the hedging relationship because all of the terms of the hedging relationship required to be matched were not.
- b. An entity met all shortcut criteria at hedge inception, but a term of the hedged item or hedging instrument changed after hedge inception that prevented the shortcut method criteria from being met from that point forward.

BC192. For the fact pattern in paragraph BC191(a), the Board concluded that an entity should perform quantitative assessments of effectiveness for all periods since hedge inception. For the fact pattern in paragraph BC191(b), the Board concluded that quantitative assessments of effectiveness should be performed only for the periods in which a term of the hedging instrument or hedged item changed that resulted in the shortcut criteria no longer being met. However, if an entity is unable to identify the period in which the shortcut criteria ceased to be met, it is required to perform quantitative effectiveness assessments for all periods since hedge inception. The Board concluded that the terms of the hedged item and hedging instrument used to perform the assessment of effectiveness should be those existing as of the date that the shortcut criteria ceased to be met.

BC193. In instances in which an entity applied the shortcut method, the Board observed that if a hedging relationship is highly effective, the likelihood of restatement will be reduced greatly compared with current GAAP. This is because the mismatch between the change in the fair value of the hedging instrument and the hedged item attributable to the hedged risk, as assessed under the specified quantitative method, likely will be immaterial to each prior reporting period and in the aggregate.

BC194. The Board considered, but rejected, several other alternatives for making the shortcut method more operable. Specifically, the Board considered adding implementation guidance to Topic 815 that would have included examples of trivial differences between the terms of the interest rate swap designated as the hedging instrument and the hedged item that would not have prevented an entity from applying the shortcut method. The Board also considered amending the language

of the shortcut method criteria that would have permitted an entity to apply limited judgment in determining whether trivial differences exist between the interest rate swap designated as the hedging instrument and the hedged item that would not have precluded application of the method. The Board concluded that the guidance that would be necessary to implement those alternatives potentially would have required ongoing maintenance as future questions arose about specific circumstances that may or may not be judged to result in a trivial difference between the interest rate swap and the hedged item. Furthermore, the Board understands that those alternatives likely would have had a limited effect in remedying the issues related to application of the shortcut method. Therefore, the Board concluded that the benefit of those alternatives would not have justified the cost of addressing those issues on an ongoing basis.

BC195. The Board also decided to integrate partial-term fair value hedges into the shortcut method criteria and, therefore, amended the shortcut criteria in paragraphs 815-20-25-104(e) and 815-20-25-105(a). It sees no conceptual reason why an entity should have been allowed to obtain fair value hedge accounting for a partial-term of the hedged item under a long-haul method but not under the shortcut method if all other shortcut method criteria are met.

Critical Terms Match Method

BC196. The Board decided to ease the application of the critical terms match method to hedges of groups of forecasted transactions. The Board concluded that for cash flow hedging relationships in which the hedged transaction is a group of forecasted transactions, an entity may assume that the hedging derivative occurs at the same time as the forecasted purchases or forecasted sales if those forecasted transactions occur and the derivative matures within the same 31-day period or fiscal month. The Board concluded that in cases in which a single derivative is designated and highly effective as a hedge of a group of exposures in which the settlement of individual transactions in the group and the derivative instrument occur within the same month but on different days, any mismatches between the change in the fair value of the hedging instrument and the individual hedged forecasted transactions should be minimal. Therefore, the Board sees this as a reasonable accommodation for hedges of groups of forecasted transactions occurring within a narrow time frame that otherwise would meet all criteria to apply the critical terms match method. The Board decided to specify a specific time frame in the guidance because it is more practicable than mandating a qualitative assessment that could create implementation issues in practice. The Board concluded that 31 days or a fiscal month is a reasonable period of time to aggregate transactions for hedging purposes.

BC197. The amendments in the proposed Update used only a 31-day time frame. In feedback on the proposed Update, stakeholders noted that some entities operate under a fiscal calendar convention in which they have a 35-day fiscal month in 1 out of every 3 months. Therefore, those entities would have been

precluded from applying the critical terms match method in the 35-day fiscal month. Because of this unintended consequence, the Board decided to clarify in this Update that the time frame may be 31 days or a fiscal month.

Qualitative Hedge Effectiveness Testing

BC198. The Board decided that an entity should perform an initial prospective assessment of hedge effectiveness on a quantitative basis for all hedging relationships unless the hedging relationship meets one of the following exceptions (that is, the hedge is assumed to be perfectly effective at hedge inception):

- a. In a cash flow or fair value hedge, the entity applies the shortcut method in accordance with paragraphs 815-20-25-102 through 25-117.
- b. In a cash flow or fair value hedge, the entity determines that the critical terms of the hedging instrument and the hedged item match in accordance with paragraphs 815-20-25-84 through 25-85.
- c. In a cash flow hedge, the hedging instrument is an option and the conditions in paragraphs 815-20-25-126 and 815-20-25-129 through 25-129A are met.
- d. In a cash flow hedge, a private company that is not a financial institution as described in paragraph 942-320-50-1 applies the simplified hedge accounting approach in paragraphs 815-20-25-133 through 25-138.
- e. In a cash flow hedge, the entity assesses hedge effectiveness under the change in variable cash flows method in accordance with paragraphs 815-30-35-16 through 35-24 and all of the conditions in paragraph 815-30-35-22 are met.
- f. In a cash flow hedge, the entity assesses hedge effectiveness under the hypothetical derivative method in accordance with paragraphs 815-30-35-25 through 35-29 and all of the critical terms of the hypothetical derivative and the hedging instrument are the same.
- g. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in spot exchange rates and the conditions in paragraph 815-35-35-5 (for derivative instruments) or 815-35-35-12 (for nonderivative instruments) are met.
- h. In a net investment hedge, the entity assesses hedge effectiveness using a method based on changes in forward exchange rates and the conditions in paragraph 815-35-35-17A are met.

BC199. The Board concluded that an entity can elect to apply a qualitative assessment of hedge effectiveness if an initial quantitative assessment demonstrates highly effective offset and at the inception of the hedging relationship the entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods. The Board also concluded that an entity should perform subsequent quantitative effectiveness assessments only if facts and circumstances related to the hedging relationship have changed such that it no longer can assert qualitatively that the hedging relationship was and continues

to be highly effective. Absent those changes in facts and circumstances, an entity may continue to assess hedging relationships on a qualitative basis in periods after the initial quantitative test is performed.

BC200. The Board's decision related to qualitative assessments of hedge effectiveness stems from the proposals in the 2008 and 2010 Exposure Drafts and the feedback received. In those Exposure Drafts, the Board proposed that an entity would not have been required to perform a quantitative assessment of the effectiveness of a hedging relationship and ongoing effectiveness assessments throughout the life of the hedging relationship. Instead, the proposal would have required a qualitative assessment of effectiveness at the inception of the hedging relationship to demonstrate that (a) an economic relationship exists between the hedging instrument and the hedged item or transaction and (b) changes in the fair value or cash flows of the hedging instrument would be reasonably effective in offsetting changes in the hedged item's fair value or cash flows attributable to the hedged risk. A quantitative assessment of effectiveness would have been necessary only if a qualitative assessment were unable to establish compliance with the reasonably effective criterion. After the inception of a hedge, effectiveness assessments would have been necessary only if circumstances suggested that the hedging relationship no longer may be reasonably effective.

BC201. Most nonuser stakeholders commented that the proposed guidance in the 2008 and 2010 Exposure Drafts on qualitative testing was too vague and that entities would simply continue to perform quantitative testing without additional guidance on when qualitative testing of hedge effectiveness would be acceptable. The Board understands that for some straightforward hedging relationships that do not qualify for the shortcut method or critical terms match method, once an initial hedge effectiveness ratio is established, it generally fluctuates within a fairly narrow band from period to period in instances in which the hedged item and hedging instrument have the same underlying. Therefore, unless facts and circumstances related to the hedging relationship change, once it is quantitatively established at hedge inception that a hedge is, for example, 95 percent effective, it is unlikely that that hedging relationship would be disqualified from hedge accounting during the life of the hedge. Therefore, the Board concluded that if an entity was required to perform an initial quantitative test of hedge effectiveness (except for hedging methods assumed to be perfectly effective at hedge inception), the issue raised in the feedback on the 2008 and 2010 Exposure Drafts would be partially resolved because the initial quantitative test provides a foundation for determining whether the hedging relationship continues to be highly effective without having to be assessed quantitatively every period.

BC202. To further address the feedback on the 2008 and 2010 Exposure Drafts and assist entities in applying judgment in determining whether hedging relationships should be tested qualitatively after hedge inception, the Board decided to provide indicators in this Update to identify the types of hedging relationships that may be eligible for qualitative testing. Those indicators focus on the level of hedge effectiveness based on quantitative assessments performed and

the alignment of the critical terms of the hedging instrument and hedged item (such as underlyings, notional amounts, maturities, quantities, locations, or delivery dates) and expectations about changes in the alignment of critical terms during the hedging relationship. The Board concluded that in cases in which hedging relationships are more volatile because the hedged item and the hedging instrument have different underlyings that are not consistently highly correlated or in cases in which hedging relationships are close to the boundaries of the highly effective threshold at hedge inception, there likely would be the need to perform quantitative assessments throughout the life of the hedge to prove that the hedging relationship continues to be highly effective.

BC203. Additionally in the 2008 and 2010 Exposure Drafts, stakeholders also were concerned that the term *changes in facts and circumstances* was too vague and needed clarification. To address this, the Board concluded that an entity should assess whether the factors that were assessed at the inception of the hedging relationship have changed such that it no longer can assert qualitatively that the hedging relationship was and continues to be highly effective and whether there have been any adverse developments in the risk of counterparty default. The Board observes that differences in critical terms in this instance do not imply that the hedging relationship is or must be perfectly effective. Rather, it means that the critical terms of the hedging instrument and hedged item continue to align such that the hedging relationship remains highly effective. The Board concluded that an entity needs to apply judgment in determining whether a hedging relationship could be tested qualitatively after a change in facts and circumstances.

BC204. The guidance in the proposed Update would have prohibited an entity from returning to qualitative assessments of effectiveness after a change in facts and circumstances required quantitative testing. The proposed requirement was based on the view that quantitative testing was necessary because facts and circumstances changed to a degree that the hedging relationship may have bordered on no longer meeting the highly effective threshold and continuing to assess the effectiveness of the hedging relationship qualitatively no longer may have been reliable. The majority of stakeholders disagreed with this proposal and argued that a change in facts and circumstances could be related to a temporary market disruption or an anomalous or infrequent event that is not expected to recur. When conditions revert to a steady state, those stakeholders maintained that an entity should be able to revert to qualitative assessments of effectiveness.

BC205. In redeliberations, the Board agreed with those stakeholders and concluded that an entity may revert to qualitative assessments of effectiveness after a change in facts and circumstances requires quantitative assessments if the entity can reasonably support an expectation of high effectiveness on a qualitative basis in subsequent periods. The entity should make that assessment by updating its analysis of the same indicators (discussed in paragraph BC202) that it considered at hedge inception in deciding to perform qualitative assessments and also considering the results of the most recently performed quantitative assessment. The Board concluded that those indicators provide a robust

framework for determining whether qualitative assessments are appropriate at any stage of the hedging relationship.

BC206. The Board also concluded that an entity may revert to qualitative testing after electing to perform a quantitative assessment (for example, as a voluntary annual validation of hedge effectiveness) and that the analysis of whether the entity may return to qualitative assessments should be the same regardless of whether the entity was required to or elected to perform a quantitative assessment. The Board also concluded that the guidance in the proposed Update could have acted as a disincentive to effective accounting controls because an entity may have avoided performing quantitative testing when it should have considered doing so.

BC207. The guidance in the proposed Update would have required an entity to assess effectiveness for similar hedges in a similar manner in selecting the hedging relationships to be assessed on a qualitative basis. However, the Board observed that this requirement may have led to unintended consequences. For example, some questioned whether an entity that documented that it would assess effectiveness on a qualitative basis but then chose to assess effectiveness for one or more hedging relationships on a quantitative basis in a subsequent period would have been required to perform a quantitative test for all similar hedging relationships. In this example, if the results of the test demonstrated that the hedging relationship was highly effective, the Board concluded that an entity should be able to apply judgment to determine whether it needed to perform a quantitative assessment for other similar hedging relationships. This is consistent with the Board's intent to provide entities more flexibility and relieve operational burden. Therefore, the Board concluded that an entity may elect to qualitatively assess hedge effectiveness on a hedge-by-hedge basis. If an entity makes this qualitative assessment election, only the quantitative method specified in an entity's initial hedge documentation must comply with the similar assessments guidance.

BC208. The Board understands that the amendments in this Update to perform initial quantitative testing and subsequent qualitative testing may be beneficial for small- and medium-sized private and public entities that have a small number of hedging relationships. However, based on outreach, the Board also understands that initial quantitative testing and subsequent qualitative testing may not be a simplification for all entities. For example, it may be more cost-effective for an entity that has a significant volume of hedging relationships to simply test all hedges quantitatively every period using existing systems than to separately select which individual hedges qualify for initial quantitative testing and subsequent qualitative testing and which hedges do not. Therefore, the Board observed that performing subsequent qualitative testing should be optional, and, in certain instances, could serve as a simplification that should not diminish the quality of information provided to users of financial statements. Those changes should ease the administrative burden of applying hedge accounting and potentially reduce costs related to ongoing quantitative hedge effectiveness assessments.

Comparing the Critical Terms Match Method and the Qualitative Method of Assessing Hedge Effectiveness

BC209. The Board considered the interaction of the qualifying criteria for the critical terms match method with the guidance to allow an entity to elect subsequent qualitative assessments of hedge effectiveness after satisfying an initial quantitative test. In instances in which an entity elects to perform subsequent assessments of effectiveness qualitatively, the amendments in this Update require that an entity perform subsequent quantitative effectiveness testing only if facts and circumstances related to the hedging relationship have changed such that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective. Therefore, performing subsequent quantitative assessments of hedge effectiveness should be based on the entity's judgment about the extent of the change in facts and circumstances related to the hedging relationship. This contrasts with the existing requirements for the critical terms match method, which specifies that if there is any change in the critical terms of the hedging instrument or the hedged asset, liability, or forecasted transaction, an entity must conclude that changes in fair value or cash flows attributable to the risk being hedged will not completely offset and the critical terms match method no longer may be applied.

BC210. The Board acknowledges that the criteria for continuing to apply the critical terms match method is more stringent than the criteria for continuing to apply the qualitative method on an ongoing basis. The Board considers this to be reasonable because no judgment needs to be applied when assessing effectiveness using the critical terms match method. In addition, this method requires no initial quantitative test to qualify for hedge accounting, and the effectiveness of the hedging relationship relies solely on the matching of the critical terms of the hedging instrument and the hedged asset, liability, or forecasted transaction at the inception of the hedging relationship and on an ongoing basis. In contrast, an entity that applies the qualitative method to assess effectiveness after hedge inception establishes the effectiveness of that hedging relationship on a quantitative basis at hedge inception. As a result, it is sufficient to require that quantitative assessments of hedge effectiveness be reinstated only if the entity determines that the terms of the relationship have changed to an extent that it no longer can assert qualitatively that the hedging relationship remains highly effective.

Changes in Facts and Circumstances in Qualitative Assessments of Hedge Effectiveness

BC211. The Board concluded that under the shortcut method, if an entity met all shortcut criteria at hedge inception but a term of the hedged item or hedging instrument changed after hedge inception that prevented the shortcut method

criteria from being met from that point forward, quantitative assessments of effectiveness should be performed only for the periods in which the shortcut criteria no longer had been met. Similarly, the Board concluded that when applying the qualitative method beginning in paragraph 815-20-35-2A, an entity should apply a quantitative method beginning in the period in which it identified a change that would indicate that qualitative assessments no longer are appropriate.

BC212. The Board also considered circumstances in which there is no identifiable event that led to the change in the facts and circumstances of the hedging relationship. In the case of the shortcut method, the Board concluded that an entity is required to perform quantitative effectiveness assessments for all periods since hedge inception. In the case of the qualitative method beginning in paragraph 815-20-35-2A, the Board took the same view in the proposed Update as it did for the shortcut method.

BC213. However, because of concerns about entities having to revisit prior conclusions associated with applying the qualitative method, the Board decided to reconsider this guidance. The Board noted a difference between the ongoing application of the shortcut method and the qualitative method. That is, the shortcut method does not require a reassessment of critical terms each period. The Board concluded that when an entity is required to make judgments about whether a change in facts and circumstances has occurred and the extent of those changes, it would be inappropriate to override judgments made in prior periods when applying the qualitative method in those prior periods was deemed appropriate.

BC214. To illustrate the point in paragraph BC213, assume that an entity performed a quantitative assessment of effectiveness as of hedge inception and qualitative assessments of effectiveness in each period thereafter. Only minor changes were observed in the hedging relationship in each period after hedge inception. The entity concluded after applying the guidance in paragraphs 815-20-35-2A through 35-2F that those changes were not significant enough to require a change to a quantitative method of assessing effectiveness. In the current period, the entity concludes that the cumulative change in the hedging relationship is significant enough to result in quantitative assessments of effectiveness being necessary. The Board believes that, in this fact pattern, the entity should not be required to reconsider prior judgments in applying qualitative testing.

Applying the Guidance in Topic 250, Accounting Changes and Error Corrections, If Qualitative Methods No Longer Apply

BC215. In instances in which an entity determines that a change in facts and circumstances occurred in a prior period but was not identified in a timely manner in that period, the Board observed that the entity should consider the applicability of the guidance in Topic 250. In addition, even if the hedging relationship was

highly effective using the long-haul methodology documented at hedge inception, the entity should still consider whether restatement of prior periods is required. If a hedging relationship is highly effective, the Board believes that the likelihood of restatement is minimal. The Board notes that if the quantitative assessments resulted in a highly effective hedge in prior periods, for shortcut-method fair value hedges, an error would be measured as the difference between the results that would have been recorded from applying the shortcut method and the results from applying the quantitative method. For all other fair value hedges, there would be no effect because the measurement of the hedged item and the hedging instrument does not change. For cash flow hedges, there would be no effect related to the removal of the requirement to recognize and measure hedge ineffectiveness. If the quantitative assessments resulted in a not highly effective hedge in prior periods, an error would be measured as the difference between not applying hedge accounting and the results recorded from applying the qualitative method.

BC216. The proposed Update contained explicit guidance on applying error correction guidance for the shortcut method, critical terms match method, and the new qualitative assessment method. The Board decided not to include that guidance in the final Update. The Board concluded that explicit guidance on applying the error correction guidance to hedging relationships under Topic 815 was unnecessary because error correction guidance must be considered for any material error and other areas in GAAP do not provide details on specific applications of that guidance.

Voluntary Hedge Dedesignation

BC217. In addition to requiring that an entity discontinue hedge accounting prospectively in certain circumstances, current GAAP also allows an entity to voluntarily discontinue hedge accounting by simply removing the designation of the hedging relationship. Both the 2008 and the 2010 Exposure Drafts would have prohibited voluntary dedesignation of hedging relationships on the basis that dedesignation should not be used as a tool for changing measurement attributes or managing the classification of certain items reported in earnings. Instead, the 2010 Exposure Draft proposed that a hedging derivative could be terminated voluntarily by entering into a derivative instrument that would fully offset future changes in the fair value or cash flows of the original derivative instrument. Additionally, the 2010 Exposure Draft would have allowed an entity to modify an existing hedging relationship by adding a derivative to the relationship if it would not reduce the effectiveness of the existing hedging relationship.

BC218. In response to the 2010 Exposure Draft and in outreach, stakeholders generally opposed prohibiting the voluntary dedesignation of hedges. Stakeholders noted that there are many valid hedging strategies that require frequent dedesignation and redesignation that would be prohibited under the

proposals. They maintained that they were unaware of any instances of abuse or earnings management related to voluntary dedesignation.

BC219. In deliberations leading to this Update, the Board decided to retain the guidance in current GAAP to allow voluntary dedesignation of a hedging relationship. Stakeholders indicated and the Board agrees that the voluntary dedesignations that occur in practice are necessary to allow an entity to react to changes in the business environment that can alter the risk profile of the underlying hedged exposure and create a need to remove, add, or change existing hedging relationships.

BC220. The Board observes that to achieve a similar accounting result as a voluntary dedesignation under the proposed guidance in the 2010 Exposure Draft, an entity would incur significant expenses to transact offsetting derivatives. Additionally, the Board understands that some hedges cannot be easily terminated by entering into a derivative that fully offsets future changes in the fair value or cash flows of the original derivative. Therefore, the Board concluded that prohibiting voluntary dedesignations would both introduce greater complexity into the hedge accounting model and result in an entity incurring additional costs to meet its risk management objectives without providing users of financial statements with a corresponding benefit.

Disclosures

BC221. Topic 815 contains extensive guidance on quantitative and qualitative disclosures for derivative instruments and hedging activities, primarily as a result of FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. The objective of current disclosure requirements is to enable users of an entity's financial statements to understand the following:

- a. How and why an entity uses derivative instruments (and nonderivative hedging instruments)
- b. How an entity accounts for its derivative instruments (and nonderivative hedging instruments) and related hedged items
- c. How derivative instruments (and nonderivative hedging instruments) and related hedged items affect an entity's financial position, financial performance, and cash flows.

BC222. Both the 2008 and 2010 Exposure Drafts would have required additional information about fair value hedging adjustments and disclosures about maturities and contractual and average interest rates associated with issued debt or other borrowings for which an entity designates interest rate risk as the hedged risk in a hedging relationship at inception of the debt.

BC223. The amendments in this Update carry forward a modified version of the disclosures proposed in the 2008 and 2010 Exposure Drafts about fair value hedging adjustments but do not carry forward disclosures about issued debt or

other borrowings. The main reason for this difference is that those proposed disclosures related to specific requirements proposed in those Exposure Drafts that were not carried forward in this Update.

BC224. In outreach following the 2010 Exposure Draft, many users expressed a desire for improved disclosures that would help them better understand an entity's risk exposures and risk management activities, the effects of hedging on future income and cash flows, and the degree of success of the entity's risk management activities. In response to users' needs, the Board decided to include in the amendments in this Update enhanced disclosures on hedging activities and the effect that those activities have on the financial statements.

BC225. The proposed Update would have required an entity to disclose its quantitative goals (if any) that it sets when developing its hedge accounting objectives and strategies and whether it met those goals. In feedback on the proposed Update, stakeholders were concerned that the proposed disclosure would not provide decision-useful information because it would be limited to hedging activities that qualify for hedge accounting, and, thus, it would not fairly reflect an entity's overall hedging strategies, which may include risk management activities outside of derivatives designated in hedging relationships. Stakeholders also noted that the proposed disclosure would be inoperable for dynamic hedging strategies that are updated frequently and that it potentially could require an entity to reveal proprietary information. On the basis of stakeholders' feedback, the Board decided not to include the disclosure in the amendments in this Update.

Disclosure about the Effect of a Fair Value Hedge on the Balance Sheet

BC226. Current GAAP requires that an entity disclose the periodic basis adjustments to the hedged item in a fair value hedge in either tabular format or nontabular format. To help users better understand the effect of hedge accounting on the balance sheet, the amendments in this Update require additional tabular disclosures about the cumulative amount of fair value hedging adjustments included in the carrying amount of hedged assets and liabilities, the line item in the balance sheet that includes the hedged assets and liabilities and the cumulative amount of the fair value hedging adjustments remaining for any hedged items for which hedge accounting has been discontinued. The Board concluded that information about the amount of those adjustments is needed for users to evaluate the amount, timing, and uncertainty of prospective cash flows associated with hedged assets or liabilities.

BC227. The proposed Update would have required an entity to disclose the carrying amount of the hedged items designated in fair value hedges. Stakeholders noted that for the last-of-layer method this would not be operable because the specific assets that form the hedged item (that is, the designated last of layer) are not yet known because the closed portfolio of prepayable financial assets exceeds

the hedged item (that is, the designated last of layer). Therefore, the disclosure was updated to require an entity to disclose the carrying amount of the hedged assets or liabilities, which allows it to disclose the amortized cost basis of the closed portfolio(s) linked to last-of-layer method hedging relationships or the hedged item for non-last-of-layer method hedging relationships. Given the unique nature of the last-of-layer method, the Board is requiring that the additional information in paragraph 815-10-50-4EEE be disclosed as well for those types of hedging relationships.

BC228. The amendments in this Update do not carry forward the proposed fair value hedging disclosures from the 2008 and 2010 Exposure Drafts, which would have required disclosing a breakdown of different measurement amounts that make up the carrying amount of a particular line item in the balance sheet. Instead, the Board decided that the amendments should focus on hedging adjustments included in the total carrying value of line items in the balance sheet. The Board concluded that most entities should have readily available access to this information and, therefore, costs should not increase.

Tabular Disclosure about the Effect of Hedge Accounting on Income Statement Line Items

BC229. Current GAAP requires tabular disclosure of the location and amount of gains and losses reported in the income statement (or other comprehensive income, as applicable) by type of contract. Gains and losses on derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments) and related hedged items are presented separately for the following:

- a. Derivatives in qualifying fair value hedges
- b. Hedged items in fair value hedges (those amounts do not have to be in a tabular format as discussed in the previous section)
- c. The effective portion of amounts in qualifying cash flow and net investment hedges recorded in other comprehensive income
- d. The amount of the effective portion of cash flow and net investment hedges reclassified from other comprehensive income into earnings
- e. The portion of gains and losses that relate to ineffectiveness and the amount excluded from the assessment of hedge effectiveness. (Note: tabular format is not explicitly required for fair value hedges.)

BC230. The Board decided to amend the tabular disclosure of the effect of hedge accounting on the income statement as follows:

- a. For fair value, cash flow, and net investment hedges, the current requirement to disclose the ineffective portion of gains and losses on hedging instruments and related hedged items is eliminated.

- b. For fair value hedges, the amount of periodic gains and losses on hedged items is included in the tabular disclosure.
- c. For cash flow hedges, the amount of gains and losses on hedging instruments shown by income and expense line item related to amounts reclassified from accumulated other comprehensive income to earnings for forecasted transactions that are probable of not occurring is included in the tabular disclosure.
- d. For fair value and cash flow hedges, the following revised tabular disclosures are required:
 - 1. The total amount of each income and expense line item in the income statement for which hedge accounting adjustments have been recorded.
 - 2. The amount of gains and losses on hedging instruments and related hedged items shown by income and expense line item so that those amounts can be compared with the total amounts of income and expense line items presented in the income statement.
 - 3. For amounts excluded from the assessment of effectiveness, separate disclosure of amounts recognized in earnings under an amortization approach or a mark-to-market through earnings approach.

BC231. The Board concluded that the revised tabular format complements the amended presentation of hedging instruments in the income statement because it more clearly depicts the effect of fair value and cash flow hedge accounting on individual income and expense line items. Furthermore, the amendment that requires an entity to include the related income and expense item totals in the tabular disclosure will allow users to access the relevant information in one location, which will clearly depict how the effects of hedge accounting relate to overall performance results.

BC232. The Board concluded that an entity will not need new information to generate the tabular disclosure. The Board also concluded that the disclosure is not an incremental requirement because it replaces two existing disclosure tables about fair value and cash flow hedges. In some cases, the Board observes that less information is required because an entity no longer is required to disclose hedge ineffectiveness. Therefore, this disclosure should not increase an entity's costs significantly.

BC233. The Board observes that when a cross-currency basis spread is excluded from the assessment of effectiveness and recognized in earnings through an amortization approach, the periodic cost of a cross-currency basis spread may be recognized in earnings through the swap's interest accruals because a component of the swap accrual is the cost of the cross-currency basis spread. If this occurs, an entity does not need to break out the portion related to the cross-currency basis spread from the swap's interest payments or receipts because it may not be practical or cost-effective to do so.

Comparison with International Financial Reporting Standards (IFRS)

BC234. IAS 39 addresses recognition and measurement of financial instruments broadly and includes guidance that permits hedge accounting for relationships that meet specified criteria. The completed version of IFRS 9 was issued in July 2014 as a replacement of the guidance in IAS 39. Once effective, IFRS 9 will significantly change the hedge accounting guidance in IAS 39 with the objective of aligning the accounting model with an entity's risk management activities.

BC235. The hedge accounting model under the current guidance in IAS 39 is similar to the guidance under current GAAP. Both permit fair value hedges, cash flow hedges, and hedges of a net investment in a foreign operation. Both have specific documentation requirements; criteria that must be satisfied to qualify for hedge accounting, including an expectation that the hedge meet a high effectiveness threshold; and a requirement to recognize hedge ineffectiveness. Additionally, both require that changes in fair value of hedging instruments designated as fair value hedges (and changes in fair value of the hedged item) be recognized in current earnings, while the effective portion of the change in the fair value of hedging instruments designated as cash flow and net investment hedges are required to be deferred in other comprehensive income. For cash flow hedges, those amounts are released into earnings concurrent with the timing of earnings recognition of the hedged item. For net investment hedges, those amounts are released into earnings when the net investment is disposed of.

BC236. The hedge accounting model in IFRS 9 and the amendments in this Update introduce greater flexibility and judgment in applying hedge accounting to align the hedge accounting model with an entity's risk management activities. However, IFRS 9 made broad changes to the eligibility of hedging instruments, hedged items, and the assessment of hedge effectiveness. The amendments in this Update largely retain the existing hedge accounting framework but incorporate targeted improvements to address various practice issues. As a result of the differing approaches of the two projects, the Board observes that certain broad principles in the amendments are different from the new hedge accounting model in IFRS 9 in the following ways:

- a. The amendments in this Update retain the highly effective threshold to qualify for hedge accounting, while IFRS 9 eliminates it. Instead, IFRS 9 requires that to qualify for hedge accounting (1) there must be an economic relationship between the hedged item and the hedging instrument, (2) the effect of credit risk does not dominate the value changes that result from the economic relationship, and (3) the designation must not reflect an imbalance between the weightings of the hedged item and hedging instrument that would create hedge ineffectiveness.

- b. The amendments eliminate the term *hedge ineffectiveness* and no longer require that effective and ineffective portions of the hedging instrument be separately recorded or disclosed. IFRS 9 retains the concept of hedge ineffectiveness and requires that hedge ineffectiveness be recognized in current earnings and separately disclosed.
- c. The amendments require an entity to record the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness in the same income statement line item as the earnings effect of the hedged item. This presentation treatment also applies to the portions of a hedging instrument's change in fair value excluded from the assessment of hedge effectiveness in fair value and cash flow hedges. IFRS 9 does not provide broad guidance on the presentation of the change in fair value of the hedging instrument.
- d. In a hedge of interest rate risk of a fixed-rate financial instrument, the amendments permit an entity to designate only a qualifying benchmark interest rate. IFRS 9 permits an entity to designate "separately identifiable and reliably measurable" components in both hedges of fixed-rate and variable-rate financial instruments.
- e. The amendments allow an entity to designate as the hedged item the last dollar amount of a closed portfolio of prepayable financial assets or beneficial interests secured by a portfolio of prepayable financial instruments. An entity may assume that if prepayments, defaults, and other factors that affect the timing and amount of cash flows occur, they are first applicable to the portion of the prepayable asset(s) that is not part of the designated hedged item. If the hedged item (that is, the designated last of layer) is breached, the entity must dedesignate the hedging relationship. IFRS 9 allows a similar approach for hedging a "bottom layer" of a group of items exposed to the same hedged risk. However, if the bottom layer includes prepayment risk, prepayment risk must be factored into the fair value of the hedged item.
- f. The amendments allow an entity to either amortize or mark-to-market through earnings amounts excluded from the assessment of hedge effectiveness (excluded components) over the life of the hedging derivative. When option premiums are excluded from the assessment of hedge effectiveness in fair value and cash flow hedges under IFRS 9, they generally must be deferred in other comprehensive income and reclassified to earnings on the basis of whether the hedged item affects earnings at a point in time or over time. IFRS 9 allows this treatment as an accounting policy election for forward points and cross-currency basis spreads.
- g. The amendments retain current GAAP and permit an entity to voluntarily dedesignate a hedging relationship. IFRS 9 prohibits voluntary dedesignation if the qualifying criteria are still met but requires rebalancing of a hedging relationship in certain circumstances.

BC237. Consistent with this project's objective, the Board considered in its deliberations whether the guidance in GAAP could be aligned with IFRS. The Board observed that there are several areas of alignment between the amendments in this Update and the guidance in IFRS 9, whereby the Board expects that many hedging relationships will result in similar outcomes, as follows:

- a. Both the amendments in this Update and IFRS 9 permit an entity to designate financial and nonfinancial components as hedged items.
- b. The amendments permit an entity to designate the variability in cash flows attributable to (1) changes in the contractually specified component in a hedge of a nonfinancial asset and (2) the contractually specified interest rate in a hedge of interest rate risk of a variable-rate financial instrument, which is similar to the concept of designating a separately identifiable and reliably measurable component under IFRS 9.
- c. The amendments permit an entity to use the benchmark rate component of the contractual coupon cash flows determined at hedge inception to measure the change in the fair value of the hedged item attributable to interest rate risk for all fair value hedges. A similar approach can be applied under IFRS 9 if the current market yield is greater than the benchmark rate at the date of hedge designation. However, IFRS 9 requires an entity to use the full contractual coupon cash flows if the market yield is less than the benchmark rate at the date of hedge designation.
- d. Both the amendments and IFRS 9 permit partial-term fair value hedges.
- e. The amendments permit subsequent effectiveness testing (after an initial quantitative test) to be performed on a qualitative basis unless facts and circumstances change. Similarly, IFRS 9 permits either a qualitative assessment or a quantitative assessment of hedge effectiveness on an ongoing basis.
- f. Both the amendments and IFRS 9 permit option premiums, forward points, and cross-currency basis spreads to be excluded from the assessment of hedge effectiveness.

BC238. Additionally, the IASB currently has a separate project on macro or portfolio hedge accounting. The project's objective is to develop an approach to reflect dynamic risk management strategies in the financial statements. The Board acknowledges that the IASB's project on macro hedging is broader in scope than the scope of this Update. However, the Board will observe the IASB's deliberations and outcomes on that project.

Effective Date and Transition

Effective Date

BC239. Based on feedback received from external stakeholders on the proposed Update, the Board concluded that the amendments in this Update are effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, consistent with the Private Company Decision-Making Framework, the Board concluded that the amendments in this Update are effective for fiscal years beginning after December 15, 2019, and for interim periods within fiscal years beginning after December 15, 2020.

BC240. In the proposed Update, the Board allowed an entity to early adopt the amendments at the beginning of any fiscal year before the effective date. Additionally, the Board concluded in this Update that an entity is permitted to early adopt the amendments in any interim period after issuance of the Update because of stakeholder feedback that the amendments are a simplification of the hedge accounting model.

BC241. If an entity adopts the amendments in this Update in an interim period, it should record the cumulative-effect adjustment for existing hedges as of the interim date of adoption in the opening balance of retained earnings as of the beginning of the fiscal year of adoption (that is, the initial application date). The Board notes that if an entity adopts the amendments as of the beginning of a fiscal year, the date of adoption and the initial application date will be the same. Stakeholders noted that applying the standard in an interim period would not create a cost-benefit concern.

BC242. The Board received feedback questioning whether consequential amendments in this Update, if adopted early, may bring forward related consequential amendments from other Accounting Standards Updates that are not yet adopted. For example, in some instances the term *marketable security* is amended by this Update to *marketable debt security* to conform with the amendments in Accounting Standards Update No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, which generally requires equity investments to be measured at fair value. The Board concluded that despite such amendments to terminology in this Update, adoption of the amendments in this Update should not force an entity to adopt the amendments of other Updates, such as the change to recognition and measurement of equity securities (which affects their eligibility for hedge accounting). Therefore, an entity should be able to hedge marketable equity securities in periods in which this Update is adopted, but Update 2016-01 is not yet adopted.

Transition Requirements

BC243. The Board concluded that an entity should apply the amendments related to the elimination of the separate measurement of ineffectiveness using a modified retrospective method that records the cumulative effect of applying this change to the opening balance of retained earnings as of the initial application date.

BC244. The Board concluded that an entity should apply this transition method to existing hedging relationships as of the date of adoption. This includes hedging relationships in which the hedging instrument has not expired or been sold, terminated, or exercised or the entity has not removed the designation of the hedging relationship.

BC245. The Board concluded that the modified retrospective method of transition is appropriate for cost-benefit reasons. Based on its research and outreach, the Board believes that the cumulative-effect adjustment generally is insignificant to an entity's financial results. Therefore, the Board concluded that a method that reduces the costs and complexities of transition is appropriate.

Transition Elections

BC246. The Board decided to provide an entity with transition elections at the time of adoption to allow the entity to take advantage of the amendments for existing hedging relationships. Those elections will assist an entity in its transition to the amendments.

Transition Elections Related to Hedge Documentation

BC247. The Board concluded that an entity is permitted to amend hedge documentation for existing hedging relationships to indicate that subsequent assessments of effectiveness will be performed qualitatively. Without this election for hedging relationships existing at adoption, taking advantage of the amendment to perform subsequent assessments of effectiveness qualitatively would be impossible without dedesignation and redesignation of the hedging relationship because entities are not allowed to retroactively amend hedge documentation.

BC248. For similar reasons, the Board decided that an entity is permitted to amend hedge documentation for existing shortcut method hedging relationships. This election allows an entity to incorporate into its hedge documentation of existing shortcut method hedging relationships how quantitative assessments of effectiveness will be performed if it is determined at a later date that use of the shortcut method was not or no longer is appropriate.

Transition Elections Related to Excluded Components

BC249. The Board concluded that in transition an entity may alter existing hedging relationships from a mark-to-market approach to an amortization approach without dedesignation. The Board decided that the entity should be able

to elect an approach for existing hedging relationships at the date of adoption that reflects its risk management strategies.

Transition Election Related to Currency Swaps

BC250. For fair value hedges, the Board concluded that an entity may update its hedge documentation without dedesignation of the hedging relationship to exclude a cross-currency basis spread from the assessment of effectiveness. This approach is consistent with the transition guidance for other changes in methodology for fair value hedges of interest rate risk. Stakeholders indicated that an entity would do this only if the excluded component (that is, the cross-currency basis spread) can be recognized in earnings through an amortization approach. Therefore, if an entity elects to exclude a cross-currency basis spread from an existing hedging relationship, the adjustment should be treated in the same manner as the adjustment discussed in paragraph BC249 when an entity elects to change its approach for recognizing excluded components in existing hedging relationships to an amortization approach.

BC251. The Board did not extend this transition provision to cash flow or net investment hedges. In a cash flow hedge, cross-currency basis spread volatility does not affect earnings. All changes in fair value of the hedging instrument are deferred in other comprehensive income, whereas they are recorded in earnings for a fair value hedge. For a net investment hedge, the excluded component model is slightly different. If an entity has historically used currency swaps as the hedging instrument and elected to assess effectiveness using the spot method, then the hedging relationship implicitly excludes the cross-currency basis spread from the assessment of effectiveness. If an entity determines that it now wishes to amortize the cross-currency basis spread (along with any other component of the currency swap's fair value excluded from the spot method of assessing effectiveness), as opposed to marking it to market, it can do so through the transition provision related to the recognition of excluded components, as discussed in paragraph BC249.

Transition Election Related to Changing the Hedged Risk in Cash Flow Hedges

BC252. The Board also decided to allow an entity to designate the variability in cash flows attributable to changes in a contractually specified component or contractually specified interest rate as the hedged risk for existing cash flow hedges. The Board understands that upon adoption preparers currently hedging the total cash flow variability of the hedged item may wish to modify the hedging relationship to hedge the risk of the variability in cash flows attributable to changes in the contractually specified component or contractually specified interest rate.

BC253. In those types of cash flow hedging relationships, the Board understands that the fair value of the hedged item typically is measured using a hypothetical derivative, which is required to be set at market terms (that is, have a fair value of zero) at the inception of a hedging relationship. Therefore, the Board decided,

upon transition, that an entity can set the terms of the revised hypothetical derivative to have a fair value of zero as of the original hedge inception date. Aligning the dates at which the hypothetical derivative and actual derivative had a fair value of zero should resolve hedge effectiveness assessment issues. Additionally, this accommodation allows an entity to more accurately reflect its risk management activities in its financial reporting immediately upon adoption.

Transition Elections for the Measurement of the Hedged Item in Fair Value Hedges of Interest Rate Risk

BC254. In the proposed Update, the Board decided that for an entity to apply the revised measurement methodologies for fair value hedges of interest rate risk existing at adoption, the entity would have had to dedesignate and redesignate the hedging relationship. The Board's intent in allowing this election was to eliminate in existing hedging relationships the earnings mismatch generated by the risk premium in the hedged item. However, the transition provision in the proposed Update would have required an entity to alter the measurement methodology of the hedged item through a dedesignation and redesignation of the hedging relationship. The Board realized that at the time of redesignation, the current benchmark rate most likely would have differed from the benchmark rate as of the original hedge designation date. Thus, the fixed rate of the hedged item (when it was measured based on the benchmark rate component of the coupon) and the hedging instrument would have still differed and the measurement mismatch in financial reporting that the Board was trying to remove would still have been present in the hedging relationship.

BC255. To correct this, the Board revised the transition provision in this Update to clarify that (a) a change in the measurement methodology for the hedged item does not require a dedesignation of the hedging relationship and (b) the benchmark rate component of the hedged item should be determined as of the original hedge inception date.

BC256. The Board learned in redeliberations that some large financial institution stakeholders try to limit the earnings mismatch generated by this risk premium by designating hedging relationships with a swap notional amount that is smaller than the hedged item's principal amount. In transition, those entities stated that they would like to measure the hedged item based on the benchmark rate component of the coupon because it would eliminate the need to designate hedging relationships in which the swap and hedged item have different notional amounts. More important, it also allows these entities to economically hedge the entire hedged item.

BC257. However, if this change is made for hedging relationships existing at adoption, an earnings mismatch would be created because of the mismatched notional amounts. Therefore, those stakeholders asked the Board if they can rebalance these hedging relationships in transition by dedesignating the portion of the debt principal amount that is in excess of the swap notional. The Board

concluded that these entities should be given the chance to adjust these hedging relationships to reflect newly allowed methodologies. Therefore, the Board concluded that the portion of the debt in excess of the swap notional may be dedesignated and the related basis adjustment recorded directly in retained earnings so that this portion of the basis adjustment would not create earnings volatility.

Transferring Debt Securities from Held-to-Maturity to Available-for-Sale

BC258. Certain financial institution stakeholders classify certain beneficial interests in the held-to-maturity category rather than the available-for-sale category because prepayment features embedded in the collateral make fair value hedge accounting difficult to obtain. By introducing the last-of-layer method in this Update, applying the fair value hedging model for beneficial interests will be less burdensome. Financial institution stakeholders requested transition relief to reclassify beneficial interests from the held-to-maturity category to the available-for-sale category. The Board concluded that an entity should be able to reclassify held-to-maturity securities that qualify for the last-of-layer method.

Timing of Applying Transition Elections

BC259. The Board concluded that each election may be applied by an entity on a standalone basis. For private companies that are not financial institutions and not-for-profit entities (except for not-for-profit entities that have issued, or are a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market), the elections must be determined before the next interim (if applicable) or annual financial statements are available to be issued. For all other entities, the elections must be determined before the first quarterly effectiveness assessment date after the date of adoption. These election dates align with the additional relief on the timing of the preparation of certain hedge documentation provided to this subset of private companies and not-for-profit entities.

Additional Transition Considerations for SIFMA

BC260. An entity may elect upon adoption to dedesignate an existing hedge of a tax-exempt security and redesignate the hedging relationship with the hedged risk defined as the changes in fair value attributable to changes in the benchmark interest rate (SIFMA Municipal Swap Rate). In that case, the primary difference in assessing hedge effectiveness and measuring hedge results relates to the measurement of the change in fair value of the hedged item attributable to the hedged risk. If such a dedesignation and redesignation occurs at adoption, the basis adjustment from the dedesignated hedging relationship must be amortized on a level-yield basis over a period of time on the basis of applicable GAAP. Because of the change in measurement methodology caused by a change in the

hedged risk, the Board considers it unreasonable for an entity to carry forward the basis adjustment from the dedesignated relationship (a hedge of total price risk) into the redesignated relationship (a hedge of the changes in fair value attributable to changes in the benchmark interest rate).

Additional Transition Considerations for Similar Hedging Relationships before and after Adoption of the Amendments in This Update

BC261. Paragraph 815-20-25-81 requires an entity to assess similar hedges in a similar manner. Therefore, if the entity wants to employ a new assessment method in this Update, it also would have to employ that method for existing similar hedging relationships at the date of adoption. However, stakeholders informed the Board of operational issues related to transitioning existing hedges to new methods that would prevent them from employing new assessment methods for hedges executed after adoption. For example, it may not be operable for some entities to calculate the opening retained earnings adjustment related to an amortization approach for excluded components; therefore, those entities would not be able to employ an amortization approach. The Board did not want an entity to be penalized if it decides to apply those provisions only on a prospective basis. Therefore, the Board concluded that an entity should not have to assess similar hedges in a similar manner when considering hedging relationships executed before and after the date of adoption for transition elections related to (a) amending documentation elections for the shortcut method, (b) designating the hedged risk as the variability in cash flows attributable to changes in a contractually specified component or a contractually specified interest rate, or (c) electing an amortization approach for excluded components.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2018 Taxonomy, are available for public comment through [ASU Taxonomy Changes](#) provided at www.fasb.org, and finalized as part of the annual release process.