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2016-310  
Comment Letter No. 4

Ms. Susan M. Cospers  
Technical Director  
File Reference No. 2016-310  
Financial Accounting Standards Board  
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3 November 2016

**Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (File Reference No. 2016-310)**

Dear Ms. Cospers:

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities* (the proposal, Proposed Update or Exposure Draft), issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's effort to improve and simplify its existing hedge accounting model. We agree that improvements to the hedge accounting model are needed to (1) better portray the economics of an entity's risk management activities in its financial statements, (2) provide information that enables users to better understand an entity's hedge results and (3) simplify the application of hedge accounting in certain situations.

Today's hedge accounting guidance has been criticized for being overly restrictive and complex. Certain common risk management strategies do not qualify for hedge accounting under the current model. For strategies that do qualify, the financial reporting results do not always accurately reflect the economics of the risk management activities undertaken. In addition, some entities choose to forgo hedge accounting for strategies that would qualify to avoid having to navigate complex rules. Financial statement users have also complained that the current model is difficult to understand and results in financial information that often does not allow them to adequately assess an entity's risk exposures and the effectiveness of the hedging strategies used to manage these exposures. As a result of these issues, many entities resort to non-GAAP disclosures to explain their hedging activities in a way they believe is more meaningful to users.

We believe the FASB's proposal responds to many of the concerns raised by preparers, users and other stakeholders about the complexity of the current hedge accounting model and the restrictions it imposes. The proposal would increase the number of hedging strategies that would qualify for hedge accounting and reduce some of the complexity of applying the model to current strategies. We also believe that pursuing targeted amendments rather than creating a new model, is the most efficient way to bring about needed change in a timely fashion.



Further, we applaud the Board for listening to the feedback it received from constituents in response to its previous exposure drafts on hedge accounting in 2008 and 2010. We believe the Proposed Update represents a significant improvement from the FASB's earlier proposals on hedge accounting.

We support the FASB's effort overall, and in particular the proposed amendments that would (1) expand risk component hedging, (2) provide entities with additional flexibility in measuring the change in fair value of the hedged item in fair value hedges of interest rate risk under the long-haul method, and (3) further align the income statement presentation and timing of earnings recognition of the hedging instrument with the hedged item in cash flow hedges.

We also support the Board's effort to simplify certain documentation and assessment requirements, including its proposals to (1) expand entities' ability to subsequently assess hedge effectiveness qualitatively and (2) allow entities to switch to the long-haul method of hedge accounting in situations where the shortcut method was misapplied. We believe the FASB's proposal would alleviate some of the complexity and operational challenges that exist in these areas.

However, there are certain aspects of the proposal that we believe the Board should reconsider, including its proposals to (1) limit component hedging of nonfinancial risks to contractually specified components and (2) prohibit an entity from using benchmark cash flows in determining the change in the fair value of the hedged item in a hedge of interest rate risk when the benchmark rate exceeds the instrument's current market yield at the inception of the hedge. In addition, we believe certain aspects of the FASB's proposal require additional guidance or clarification. These issues are addressed in either Appendix A or Appendix B to our letter.

Appendix A to this letter provides our responses to the Questions for Respondents included in the Exposure Draft. Appendix B includes other observations and recommendations related to the Board's proposal that were not captured in our responses to the Questions for Respondents.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

*Ernst & Young LLP*

## **Responses to the Questions for Respondents included in the FASB's Exposure Draft**

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

We agree with the Board's decision to allow entities to hedge contractually specified risk components in cash flow hedges of forecasted transactions involving nonfinancial items. In addition, while this is not the focus of the FASB's question, we also agree with the Board's decision to allow entities to hedge contractually specified interest rates in cash flow hedges of variable-rate financial instruments. We believe these changes would result in financial reporting that more accurately reflects how entities manage both financial and nonfinancial risks.

### **Hedging nonfinancial risk components**

We have long believed that hedging components of nonfinancial risk should be permitted under US GAAP for many of the same reasons that US GAAP allows the hedging of components of financial risk. Thus, we welcome the FASB's proposal and believe it would create greater consistency between the accounting for hedges of nonfinancial risks and the accounting for hedges of financial risks.

We believe the Board's proposal would result in better financial reporting because it would further align the hedge accounting requirements with an entity's risk management activities. Many entities employ hedging strategies related to the forecasted purchase or sale of nonfinancial assets that focus on hedging a particular component of the total price. As a result, the requirement in current US GAAP that the hedged risk be designated as the variability in total price leads to the recognition of ineffectiveness or, in some cases, the failure to qualify for hedge accounting at all. This is the case even though the variability that creates the ineffectiveness, or the inability to apply hedge accounting, typically results from a factor, such as basis risk, that the entity never intended to hedge. The Board's proposal would resolve this fundamental weakness in the existing hedge accounting model, at least as it pertains to components that are contractually specified.

### ***Other than contractually specified components***

As we said in our comment letter on the FASB's 2011 Discussion Paper, *Selected Issues on Hedge Accounting (Including IASB Exposure Draft, Hedge Accounting)*, we do not believe that the ability to hedge components of nonfinancial risk should be limited to those components that are contractually specified. Instead, we generally believe that entities should be able to hedge a component that is "separately identifiable" and "reliably measurable" within the context of the particular market structure to which the risk or risks relate and in which the hedging activity takes place. We observe that this is allowed under IFRS 9, *Financial Instruments*. However, if the Board permits hedge accounting for components of nonfinancial risks beyond risks that are contractually specified, we believe it should provide implementation guidance (beyond what is included in IFRS 9) regarding how to determine whether a component is eligible for hedge accounting.

As we previously suggested in our comment letters to the IASB and FASB on hedge accounting, it would be helpful for the Board to provide guidance on potential factors to consider such as whether:

- ▶ The component is a physical ingredient of the whole item
- ▶ It is common market practice to include the component in pricing
- ▶ There is statistical evidence indicating consistent price sensitivity to the component
- ▶ The risk component is actively traded and therefore liquid prices are readily available

Any additional implementation guidance could also address the concerns the Board noted in paragraph BC50 of the Proposed Update in describing its rationale for deciding not to allow non-contractually specified components to be designated as the hedged risk.

The Board also observes in that paragraph that in situations where a market convention exists, contracts could be rewritten to contractually specify the convention, thereby making the variability in cash flows attributable to changes in the price of the component an eligible hedged risk. While this may be true in some instances, we are not sure this would address all hedging strategies, including situations where the hedged risk stems from a forecasted transaction for which a formal contract does not, and will not, exist (e.g., the purchase of a commodity in the spot market).

In addition, rewriting or amending contracts could be time consuming and costly, especially for entities that transact with many different counterparties. Obtaining counterparty consent also may be challenging for smaller entities that lack the power to demand these changes solely to achieve a desired accounting result.

We note that requiring nonfinancial risk components to be contractually specified to qualify as hedged risks would retain certain inconsistencies between the hedging of nonfinancial risks and financial risks. For example, it is our understanding that entities would still be prohibited from hedging a risk component associated with a forecasted fixed-price nonfinancial contract, even though current US GAAP provides entities the ability to hedge benchmark interest rate risk related to the forecasted issuance of fixed-rate debt.

We understand that it is common for companies in certain industries (e.g., the agriculture industry), to enter into fixed-price contracts to acquire commodities (e.g., corn, wheat) at a specific location. However, the farmers that sell these commodities are typically only willing to lock in a fixed price one to two months prior to delivery. As a result, companies hedge the price risk associated with future commodity purchases from the date the forecasted purchase transaction is deemed probable (e.g., six months in advance of delivery) to the date when they enter into a fixed-price contract (e.g., one month prior to delivery). Based on the proposed guidance in paragraphs 815-20-25-22B and 815-20-55-26A through 55-26C, it would appear that an entity would be required to designate the total price risk (including basis risk) as the hedged risk because the entity expects to enter into a fixed-price contract in the future. Expanding component hedging for nonfinancial risks beyond contractually specified components would alleviate this inconsistency and align the accounting for this common strategy with the reporting entities' risk management activities.

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

- a. Should the Board retain the current concept of benchmark interest rates for fair value hedges of fixed-rate financial instruments and for cash flow hedges of forecasted purchases or issuances of fixed-rate financial instruments? Please explain why or why not?
- b. If the Board continues to maintain the current concept of benchmark interest rates, should the Board consider within the concept expectations that a rate will become widely used?
- c. If the Board continues to maintain a list of rates, are there any other rates that should be added to the list? Please explain why a particular rate meets the definition of a benchmark rate.
- d. Are there other alternatives to the current concept of benchmark interest rates the Board should consider (for example, a principles-based approach)? Please describe those alternatives.

While we agree with the Board's decision to retain the concept of benchmark interest rates for hedges of fixed-rate financial instruments, we question the appropriateness of continuing to include a list of permissible rates in the guidance that will need to be updated as markets evolve.

We note that the FASB amended the guidance to add the Overnight Index Swap Rate (OIS) to the list of permissible benchmark rates in 2013 and is now proposing to add the Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Rate to this list. Future amendments could result from the work of the Alternative Reference Rates Committee (ARRC),<sup>1</sup> which is tasked with identifying a set of alternative reference interest rates.

While we agree that the OIS and SIFMA swap rates are appropriate benchmark interest rates, as we expect any alternatives identified by the ARRC will be, we question the process (including the time and effort) that is required to add any new rate to the accounting literature.

We note that US GAAP does not contain a list of permissible benchmark interest rates for debt markets outside the US and IAS 39 and IFRS 9 do not contain such a list either. Despite this, we are not aware of any practice issues involving entities identifying benchmark rates to be hedged in debt markets outside of the US (when applying US GAAP) or for entities applying IFRS.

We therefore suggest that the Board reconsider providing a principles-based approach for identifying widely used and quoted benchmark interest rates that could be designated as the hedged risk in fixed-rate financial instruments. If the Board decides to move forward with an explicit list of permissible benchmark interest rates for the US, we recommend that it develop a process to more quickly add widely used and quoted rates to the list as market forces dictate.

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<sup>1</sup> The ARRC was convened in 2014 by the Federal Reserve at the recommendation of the Financial Stability Oversight Council to identify a set of alternative reference interest rates that are more firmly based on transactions from a robust underlying market and that comply with emerging standards, such as the International Organization of Securities Commissions' *Principles for Financial Benchmarks*.

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

We agree with the Board's decision to allow entities to use the cash flows associated with the benchmark rate determined at hedge inception to calculate the change in fair value of the hedged item attributable to interest rate risk. We believe this would result in accounting for fair value hedges of interest rate risk under the long-haul method that better reflects the economics of an entity's risk management activities.

The requirement under current US GAAP that an entity use the total contractual coupon cash flows (which generally incorporates a credit spread) to determine the change in the fair value of the hedged item attributable to interest rate risk creates a disconnect between the accounting results and the economics of the hedge relationship, which is to solely hedge benchmark interest rate risk. This disconnect results in an earnings mismatch that we believe misrepresents the true effectiveness of the hedge relationship because it includes a portion of the financial instrument that the entity is not intending to hedge (i.e., the credit spread on the financial instrument).

Although we believe that using benchmark cash flows is more consistent with the true economics of a hedge of benchmark interest rate risk, we do not disagree with Board's decision to, for practical reasons, continue to allow entities to use the total coupon cash flows to calculate the change in the fair value of the hedged item attributable to interest rate risk. As the Board notes in paragraph BC117 of the Proposed Update, some entities may want to continue to use this approach when the benefits of revising their measurement methodology do not justify the costs associated with changing their existing processes.

### **Sub-benchmark issue**

While we strongly support the Board's decision to permit the use of benchmark cash flows, we question its decision to prohibit entities from using the cash flows associated with the benchmark rate to calculate the change in the hedged item's fair value attributable to changes in interest rate risk when the current market yield of the hedged item is less than the benchmark interest rate at the inception of the hedge (commonly referred to as the sub-benchmark or sub-Libor issue).

The Board's reasons for imposing this limitation are not clear to us. We note that a comparable limitation does not exist for an entity seeking to hedge interest rate risk in a variable-rate financial instrument whose coupon payments are based on a contractually specified variable interest rate (e.g., Libor) less a fixed credit spread. In discussing its reasons for proposing to amend the guidance related to partial-term fair value hedges, the Board notes in paragraph BC126 of the Proposed Update that many stakeholders believe "treasurers view risk management as managing cash flows (such as managing the fixed/floating cash flow profile) rather than managing instruments." With this view in mind, it is difficult to understand why an entity's consideration of a negative credit spread should differ when hedging benchmark interest rate risk in a fair value hedge and a cash flow hedge if in both instances, the entity is trying to manage its fixed/floating cash flow profile as noted above.

In addition, we note that this limitation has the potential to increase complexity. For example, it is not clear to us how this limitation would be applied to convertible debt instruments when the current market yield at hedge inception is lower than the benchmark interest rate due to the value of the embedded conversion option. If the Board decides to move forward with this limitation on the use of benchmark cash flows, we recommend that it provide additional guidance to address these situations. Likewise, the Board should clarify that the market yield and benchmark rate being compared at hedge inception in partial term fair value hedges would be based on the assumed hedged item whose maturity matches the derivative instrument, not the actual hedged item.

If the FASB decides to move forward with the sub-benchmark limitation, we support its decision to compare the benchmark rate to the current market yield of the hedged item at the time of hedge designation, rather than the contractual coupon rate, which would be based on the market environment at the time the debt was issued. Considering the contractual coupon rate would potentially prevent an entity from using benchmark cash flows to measure the change in fair value of the hedged item in a "late hedge" simply because benchmark interest rates changed from the time the debt was issued to the time the hedge was designated.

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

A pattern of missed forecasts has been interpreted in practice to mean as few as three missed forecasts (i.e., three separately hedged forecasted cash flows that were later deemed probable to not occur). While two missed cash flow forecasts may not constitute a pattern, we believe the second incorrect forecast should cause the entity to challenge its forecasts for existing and new similar hedge relationships. In addition, this may cause the entity to reduce its hedge ratios (i.e., the hedged percentage of a forecasted transaction) for existing and new similar hedge relationships.

In considering whether there is a pattern of missed forecasts that could call into question an entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions, we believe certain events are easier to overcome than others. For example, in our view, disruptions due to natural disasters such as hurricanes that are not expected to recur would not ordinarily call into question an entity's ability to accurately predict forecasted transactions.

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

As written, this question seems focused only on hedge relationships that would qualify for hedge accounting under both IFRS 9 and the Proposed Update, not hedge relationships that would qualify for hedge accounting under one standard but not the other. Given the "threshold" difference that

would exist between the two standards as discussed in paragraph BC161a of the Proposed Update, we note there could be a number of hedge relationships that would qualify for hedge accounting under IFRS 9 but not under the Proposed Update.

With respect to the Board's specific question on hedging relationships that would be eligible to meet the requirements under both the FASB's proposal and IFRS 9, but whose results would be recognized and presented differently, we note that this would likely be the case for any cash flow hedges that are not perfectly effective. Given the FASB's proposed amendment to eliminate the requirement to separately measure and report ineffectiveness, the entire change in fair value of the hedging instrument included in the assessment of hedge effectiveness would be deferred in accumulated other comprehensive income (AOCI) until the hedged item affects earnings. In contrast, under IFRS 9 any ineffectiveness in a cash flow hedge (i.e., amounts related to "over-hedges") would continue to be recognized in earnings immediately.

In addition, unlike the FASB's proposal, IFRS 9 does not contain broad presentation guidance.

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

- a. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would modify current GAAP by requiring the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is presented.
- b. For qualifying fair value, cash flow, and net investment hedges, the proposed amendments would retain current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be recorded currently in earnings. For qualifying fair value and cash flow hedges, the proposed amendments would modify current GAAP by requiring changes in the fair value of the hedging instrument excluded from the assessment of effectiveness to be presented in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. For qualifying net investment hedges, there will be no prescribed presentation requirements for changes in the fair value of the hedging instrument excluded from the assessment of effectiveness.
- c. For cash flow hedges in which the hedged forecasted transaction is probable of not occurring, the proposed amendments would retain current GAAP by requiring amounts recorded in accumulated other comprehensive income to be reclassified to earnings immediately. However, the proposed amendments would require presentation of reclassified amounts in the same income statement line item in which the earnings effect of the hedged item would have been presented had the hedged forecasted transaction occurred.

We generally agree with the Board's decisions on presentation. The proposal would eliminate diversity in practice that currently exists with respect to where entities report different aspects of their hedge relationships (i.e., ineffectiveness and excluded components).



## Cash flow hedges

We agree with the Board's decision to require that the entire change in the fair value of the hedging instrument included in the assessment of hedge effectiveness be presented in the same income statement line item in which the earnings effect of the hedged item is presented. Taken in conjunction with the proposed amendments to eliminate the need to separately measure and report ineffectiveness in current earnings, we believe this would provide increased transparency into the overall cost and effectiveness of an entity's cash flow hedge relationships as the earnings recognition and presentation of the hedging instrument and the hedged item would be better aligned.

Also, we generally agree with the Board's decision to require that the changes in the fair value of the hedging instrument excluded from the assessment of effectiveness be presented in the same income statement line item in which the earnings effect of the hedged item is (or will be) presented. This would result in consistent presentation in the income statement of all changes in the fair value of the hedging instrument in a cash flow hedge and fits with the Board's "cost of hedging" model discussed in paragraph BC62 of the Proposed Update.

We recognize that the timing mismatch between when the excluded amount is recognized in earnings and when the hedged item and the rest of the changes in the fair value of the hedging derivative are recognized in earnings, could be viewed to result in a suboptimal alignment between the hedging instrument and the hedged item. However, we believe this to be an issue regarding the timing of when the change in a hedging instrument's time value that is excluded from the assessment of hedge effectiveness should be recognized in earnings, not where this amount should be reported.

Accordingly, if financial statement users raise concerns about this mismatch, the Board could consider whether it would be more appropriate to defer the earnings recognition of the excluded time value of the hedging instrument to better align with the effect of the hedged item on earnings. Such an approach would be similar to the treatment of an option's time value when hedge effectiveness is based on an option's terminal value in accordance with the guidance in Derivatives Implementation Group (DIG) Issue G20, *Cash Flow Hedges: Assessing and Measuring the Effectiveness of a Purchased Option Used in a Cash Flow Hedge*, which is codified in various places in the Accounting Standards Codification (ASC) 815.<sup>2</sup>

Finally, we agree with the Board's decision that amounts reclassified from AOCI to earnings when a hedged forecasted transaction is deemed probable of not occurring be presented in the same income statement line item in which the earnings effect of the hedged item would have been presented if the hedged forecasted transaction had occurred. Even when the forecasted transaction being hedged will not affect earnings (because it does not occur), the change in fair value of the hedging instrument during the period when the hedge was in place can be viewed as a cost associated with an entity's hedge accounting strategy. We note that this treatment seems consistent with the Board's "cost of hedging" model discussed in paragraph BC62 of the Proposed Update.

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<sup>2</sup> ASC 815-20-25-126 through 25-129, 815-20-55-209 through 55-211, 815-30-35-33 through 35-37 and 815-30-55-127.

## Fair value hedges

For fair value hedges, we note that the requirement to present all changes in the fair value of the hedging instrument (including amounts excluded from the assessment of hedge effectiveness) in the same income statement line item in which the earnings effect of the hedged item is presented may not necessarily be viewed as enhancing transparency. This is due to the effect that such an approach could have on the presentation of certain key income statement line items, such as interest expense. For example, under the FASB's proposal, in a hedge of fixed-rate debt with an interest swap that is not fully collateralized, valuation adjustments made to the overall fair value of hedging instrument related to credit risk (i.e., CVA or DVA) would be reported in the current period's interest expense. While the effect of presenting these derivative valuation adjustments in interest expense would ultimately net out over the life of the hedge relationship (assuming there is no default on the hedging instrument), the Board's proposal would result in increased volatility in the interest expense reported in each period.

The effect of derivative valuation adjustments (such as CVA or DVA) on the hedging instrument's fair value results in an earnings mismatch in fair value hedges under existing US GAAP. However, it is our understanding that many entities do not report this aspect of the change in the hedging instrument's fair value in the interest expense line item because they believe including the effect of derivative valuation adjustments would distort this line item. For example, this is may be the case for financial institutions where net interest margin is a key performance metric used by financial statement users.

Accordingly, we believe the FASB should perform additional outreach with financial statement users to confirm that they believe such a requirement would enhance transparency and improve financial statement reporting.

## Net investment hedges

We agree with the Board's decisions on presentation related to net investment hedges.

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

- a. Cumulative basis adjustments related to fair value hedges
- b. Quantitative hedge accounting goals, if any, that an entity sets when developing its hedge accounting objectives and strategies and whether it met those goals
- c. Revised tabular disclosure for fair value and cash flow hedges that would focus on the effect of hedge accounting on income statement line items.

We support the Board's efforts to enhance transparency regarding an entity's risk exposures and the hedge accounting activities used to manage these exposures. However, as noted in previous comment letters, we continue to believe that it would be beneficial for the Board to complete its Disclosure Framework Project, including the Board's Decision Process, prior to imposing new disclosure requirements. The objective of the Board's Decision Process is to develop a framework to help it identify disclosures to be considered when setting requirements for individual accounting standards and evaluating existing requirements.

We therefore suggest that the FASB consider holding off on making changes to the disclosure requirements of ASC 815 until it completes work on its Disclosure Framework. To be clear, we are not suggesting that the issuance of the Proposed Update be delayed until this occurs. In our view, none of the proposed disclosure amendments are critical to entities adopting the FASB's proposal, with the exception of eliminating the requirement to disclose the ineffective portion of the change in the fair value of the hedged item.

If the FASB instead chooses to move forward with the proposed disclosure requirements, we believe additional clarity is needed regarding the objective of the proposed requirement that an entity disclose its quantitative hedge accounting goals, if any, that it sets when developing its hedge accounting objectives and strategies and whether it met those goals. Given the dynamic nature of many entities' risk management activities, it is our understanding that an entity's objectives and strategies regarding amounts to be hedged are generally not static. Instead, these amounts may change frequently based on market dynamics and, in many instances, the amounts may not be finalized until near the time that the hedge transaction is entered into.

In addition, due to the nature of the accounting requirements, strategies and objectives specific to hedge accounting may be more transactional as compared to broader risk management strategies employed by an entity and discussed in the management discussion and analysis section of the financial statements when material. In these cases, it's unclear what level of disaggregated disclosure would be required. It's also unclear how beneficial indicating that the goal was met would be to financial statement users since we understand "meeting the goal" to mean that the entity hedged the amount it intended to hedge. When the "goal" is determined near the execution date of the hedge, it is unclear to us why that goal would not be met.

We believe the Board should perform additional outreach to better understand the costs and benefits associated with such a disclosure, given the dynamic risk strategies that many entities employ.

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

We agree with the proposed change. We believe that allowing entities to subsequently assess hedge effectiveness on a qualitative basis, even when the terms of the hedging instrument and the hedged item do not perfectly match, will simplify the application of hedge accounting by eliminating the need for companies to devote resources to perform quantitative statistical analyses to prove the effectiveness of certain hedge relationships that can be easily assessed qualitatively with a minimum amount of financial intuition.

In addition, we believe the ability to assess hedge effectiveness qualitatively could result in a reduction in the number of hedging relationships discontinued as a result of issues stemming from "the law of small numbers." This can occur during periods when the underlying to the hedge relationship remains relatively stable and the small dollar differences between the change in the value of the hedging instrument and the hedged item can result in percentage differences outside the acceptable range for the hedge relationship to be considered highly effective. Under current US GAAP, companies that use

dollar-offset assessment methodologies sometimes must terminate their hedge relationships during these periods, even though the economic relationship of the derivative and the hedged item remains strong. Typically, a more robust assessment methodology such as regression would have supported the continuation of such hedge relationships.

Although we agree with the Board's decision to expand the ability for entities to subsequently assess hedge effectiveness on a qualitative basis, we believe additional guidance to further clarify the principles underlying such an assessment would be beneficial. This could increase consistency in the application of this guidance and enhance auditability.

As noted by the Board in paragraph BC81 of the Proposed Update, while most constituents supported the expansion of qualitative assessments in comments on the 2008 and 2010 exposure drafts, they indicated that the proposed guidance was too vague. We applaud the Board for trying to address this concern in its latest proposal. For example, the proposed implementation guidance in paragraphs 815-25-55-79G through 55-79N discusses the types of hedging relationships that would be eligible for qualitative effectiveness testing. In addition, paragraph 815-20-35-2C of the Proposed Update indicates that an entity would be required to verify and document that the facts and circumstances related to the hedging relationship have not changed to an extent that it could no longer assert qualitatively that the hedging relationship was and continues to be highly effective. This paragraph also includes a number of indicators that may support an entity's assertion that a qualitative assessment of effectiveness continues to be appropriate.

While this guidance is helpful, we believe additional clarity as to whether the Board expects an entity's up-front quantitative prospective analysis to be more robust when the entity plans to subsequently assess hedge effectiveness qualitatively would be useful. The proposed guidance in ASC 815-20-55 79Gb. states that "[i]f one or more of the critical terms of the hedging instrument and the hedged item are not aligned at inception, an entity should consider whether changes in market conditions may cause the changes in fair values 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." [Emphasis added.]

We agree with this statement, but believe the Board should consider addressing whether the initial qualitative assessment would include scenario or stress testing to determine the extent to which market factors could change without calling into question whether the entity can assert qualitatively that the hedge is still expected to be highly effective. Such an approach may be especially helpful in situations where a high level of correlation has existed between the hedging instrument and the hedged item under relatively stable market conditions.

In addition, we note that the proposed guidance in ASC 815-20-35-2Ca. states that an entity should consider whether "the factors that were assessed at the inception of the hedging relationship that enabled the entity to reasonably support an expectation of high effectiveness on a qualitative basis have not changed to an extent that the entity no longer can assert qualitatively that the hedging relationship was and continues to be highly effective." The historical correlation between the hedging instrument and the hedged item would likely be one of the primary factors an entity would consider in making this determination. As such, the above guidance would seem to indicate that an entity should continue to monitor and document that this correlation remains high as part of its qualitative assessment of effectiveness. Because it might be necessary to calculate the correlation in order to monitor that it remains high, this requirement could be seen as being more akin to a quantitative analysis.

Finally, we note that the proposed amendments in ASC 815-20-35-2Cc. and d. address situations when there is an embedded cap or floor in the hedged item that is not mirrored in the hedging instrument. The proposed guidance indicates that a qualitative assessment of hedge effectiveness could continue as long as the rate/price associated with the contractually specified component “does not approach” (or move above or below) the rate/price associated with the cap or floor. While we believe the Board intended to highlight the need to consider whether the time value associated with the cap or floor embedded in the hedged item (but not the hedging instrument) would cause the hedge relationship to no longer be highly effective, it is unclear to us how the “does not approach” concept would be applied in practice. If the Board intended this guidance to represent something akin to a “practical expedient” to enable qualitative assessment of hedge effectiveness in these situations as long as it remains unlikely that the embedded cap or floor will be triggered, we suggest that Board state this more clearly.

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

There could be a number of situations where an entity could no longer assert qualitatively that the hedge is expected to be highly effective, but quantitative testing would indicate the hedge is still highly effective. In our view, the likelihood of this outcome would seem to increase if an entity does not perform a more robust quantitative prospective analysis at hedge inception as discussed in our response to Question 8. In these situations, we would expect that any entity may not be able to qualitatively assert that the hedge has been, and is expected to continue to be, highly effective without performing a quantitative analysis if market conditions change to a degree that was not originally captured by the entity’s initial quantitative hedge assessment test. In this case, although a qualitative assessment may no longer be applicable, the hedge may remain highly effective based on the results of a quantitative analysis that incorporates the new market conditions.

We do not agree with the Board’s decision to prohibit qualitative testing after an entity determines that a quantitative assessment of effectiveness is required in a given period. That is, we do not understand why the Board would preclude an entity from returning to assessing hedge effectiveness qualitatively without considering the specific facts and circumstances.

Consider, for example, a fact pattern similar to the one described in paragraphs 815-20-55-79P through 55-79R of the Proposed Update involving an entity that is required to begin to perform quantitative hedge effectiveness assessments when Currency X (the currency being hedged ) is no longer pegged to the euro (the underlying in the hedging instrument). Now assume that at the some point in the future, during the life of the hedge, Currency X is once again pegged to the euro. We see no reason why the entity should be prohibited from returning to assessing hedge effectiveness

qualitatively. While this fact pattern may be unlikely, it illustrates why we do not agree with a blanket prohibition on an entity being able to return to a qualitative assessment once a quantitative assessment of a hedge relationship is deemed necessary in a given period(s).

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

We agree with the Board's decision to give entities additional time to perform their initial quantitative effectiveness testing. Relaxing this requirement may provide relief to entities that do not undertake significant hedging activities or that lack the resources to complete this analysis on the date the hedge is executed. We believe it is appropriate to give entities until the end of the quarter in which the hedge is executed to perform this testing, depending on the facts and circumstances as discussed in the Proposed Update.

We also agree with the provisions the Board has proposed to ensure that companies would not have the benefit of hindsight in determining whether to designate a derivative instrument as part of a hedge relationship. This includes requiring that all other aspects of the hedge documentation, including the methodology that would be used to initially assess hedge effectiveness prospectively when the qualitative testing is performed, be completed concurrently with the inception of the hedge.

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

We generally believe the timing (and content) of hedge documentation should be same for public entities and private companies. As discussed in our response to Question 10, we believe concurrent designation and documentation of a hedge relationship is critical to ensuring that entities cannot apply hindsight in determining whether to apply hedge accounting in a given period.

In addition, absent a change to the requirement that hedge effectiveness be assessed at least quarterly by all entities (including private companies that only issue annual financial statements), it would seem difficult for the Board to provide private companies with significantly greater flexibility regarding the timing of when hedge documentation or subsequent assessments of hedge effectiveness may be completed.

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

As long as all entities would have the ability to early adopt the Proposed Update at the beginning of any fiscal year after its issuance, we would support providing a later effective date for entities that are not public business entities.

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

Given that the Proposed Update generally would reduce complexity in the application of hedge accounting, many entities may not require an extended implementation period. However, we are sensitive to the fact that some companies may face resource constraints, given the amount of effort that will be required to implement other significant accounting changes related to revenue recognition, lease accounting and credit impairment of financial instruments.

Therefore, we would support an implementation period of at least one year, provided that entities have the ability to early adopt the Proposed Update at the beginning of any fiscal year after its issuance. For example, if the standard were issued in 2017, the required effective date could be for fiscal years beginning after 15 December 2018.

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

We agree with the Board's decision to require adoption of the Proposed Update using a modified retrospective approach. Although applying this approach has the potential to result in previously recognized hedge ineffectiveness for cash flow hedges being reported through earnings more than once,<sup>3</sup> we believe this approach is superior to either a prospective or full retrospective transition approach when considered from a cost/benefit perspective.

Adopting the Proposed Update on a prospective basis (i.e., applying the guidance to hedge relationships entered into after the date of adoption) would result in entities needing to apply two different hedge accounting models until its existing hedges expire if they don't dedesignate and redesignate these existing hedging relationships upon adoption, which has the potential to create its own complications. As such, we believe a prospective approach would be costly and cumbersome for preparers to apply and difficult for users to understand.

Requiring full retrospective application would also be costly and complex because it would require entities to apply the guidance to hedge relationships that no longer exist as of the date of adoption (i.e., those that existed during the comparable periods presented in the financial statements and those that were terminated years earlier). For example, this would be the case in a cash flow hedge of interest rate risk related to the forecasted issuance of fixed-rate debt that was terminated years earlier (at the time the debt was issued) but continues to have amounts reported in AOCI awaiting reclassification to earnings.

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<sup>3</sup> As an example, consider an existing hedge of a single cash flow where ineffectiveness of \$100 has been recognized in earnings prior to adoption of the Proposed Update, consistent with existing US GAAP. Under the modified retrospective transition approach, upon adoption, this amount would be recorded in AOCI with an offset to beginning retained earnings. When the hedged item affects earnings, this amount could once again be recorded in earnings as part of the reclassification of amounts in AOCI to earnings.

We understand that some entities may wish to voluntarily adopt the Proposed Update using a full retrospective transition approach to provide users with consistent accounting for all periods presented in the financial statements. While we share the Board's concerns about giving entities the option to use a full retrospective approach for the reason discussed in paragraph BC175 of the proposal, we suggest that the Board reconsider whether such an option could be provided under certain circumstances. For example, if the entity does not have existing fair value hedges of interest rate risk or if it chooses not to change the measurement methodology for these hedges.



## **Other matters**

We have the following additional observations and recommendations related to the guidance in the Proposed Update and other issues we believe the Board should consider addressing in the Proposed Update.

### **Observations and recommendations on guidance in the Proposed Update**

#### ***1) Definition of a contractually specified component***

A contractually specified component is defined in the Proposed Update as "[a]n 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."

We believe additional clarity is needed regarding the characteristics required to constitute an agreement. For example, it is unclear whether an entity would be able to designate a contractually specified component as the hedged risk in the forecasted purchase or sale of a commodity in the spot market if it receives an invoice or receipt at the time of purchase or sale that specifies how the spot price was determined (i.e., the spot price paid or received is decomposed into its components).

#### ***2) Hedging components of nonfinancial risk***

Paragraph 815-20-55-19 in the Proposed Update seems to indicate that if the contract that specifies the variable price component to be hedged is determined to be a derivative, an entity would be precluded from hedging the contractually specified risk component associated with this contract unless the normal purchases and normal sales scope exception to derivative accounting is elected for the contract. This concept is illustrated in the following examples:

##### ***Variable price contract***

Assume that on 1/1/XX Entity A enters into a contract to purchase commodity Y at location X on 6/30/XX. The contract states that Entity A will pay a price equal to the spot price of a specified market index for commodity Y as of 6/30/XX, plus a variable basis adjustment related to location X. Because commodity Y is deemed to be readily convertible to cash, this contract meets the definition of a derivative. In addition, assume that while the forecasted transaction to acquire commodity Y is probable, the contract does not qualify for the normal purchases and normal sales scope exception. As a result, this contract is technically accounted for as a derivative, even though its fair value is expected to remain zero because it represents a contract to purchase a commodity at its fair value.

Entity A would like to hedge the variability in cash flows associated with changes in the market index for commodity Y but not the basis adjustment. As such, Entity A enters into a futures contract with an underlying based on the market index for commodity Y. In this situation, the Proposed Update would seem to indicate that Entity A would be required to designate the variability in cash flows related to

the total purchase price (including the variable basis adjustment) as the hedged risk, even though it entered into a contract that specified the risk component it wanted to hedge.<sup>4</sup>

While we don't necessarily agree with this outcome, if this is in fact the Board's intention, we believe it should be clarified further.

### ***Mixed-price commodity contract (basis is fixed)***

Assume that on 1/1/XX, Entity A enters into a contract to purchase commodity Y at location X on 6/30/XX. The contract states that Entity A will pay a price equal to the spot price of a specified market index for commodity Y as of 6/30/XX, plus a fixed basis adjustment of \$10 related to location X. As discussed in ASC 815-10-55-83, the whole mixed-attribute contract meets the definition of a derivative because the basis differential is a market variable in determining the final transaction price under the contract, and this variable has been fixed in the contract, producing an underlying. In addition, assume that while the forecasted transaction to acquire commodity Y is probable, the contract does not qualify for the normal purchases and normal sales scope exception. As a result, this contract is accounted for as a derivative whose fair value is based on changes in the value of the basis adjustment.

Under current US GAAP, the guidance in ASC 815-20-55-46 through 55-47 (formerly DIG Issue A11) discusses why this mixed-attribute derivative would not be an effective cash flow hedge of the anticipated commodity purchase since it does not eliminate the variability in the base commodity price. However, this guidance goes on to state that the mixed-price contract may be combined with another derivative whose underlying is the base commodity price (e.g., a futures contract), with the combination of these derivative instruments designated as the hedging instrument in a cash flow hedge of the overall variability of cash flows for the anticipated purchase of the commodity.

It is unclear to us why the FASB is proposing to eliminate paragraphs 815-20-55-46 through 55-47 as it would seem this guidance would continue to be applicable to mixed-priced commodity contracts that meet the definition of a derivative and do not qualify for the normal purchases and normal sales scope exception. We are concerned that eliminating this guidance could lead some to believe that the variability in the forecasted purchase of the commodity would relate solely to the base commodity price (since the basis has been fixed), and therefore the mixed-price derivative could not be designated as a hedging instrument, even in combination with a derivative whose underlying is the base commodity price. We do not believe this was the Board's intent.

### **3) Consistency in hedge assessments**

We agree with the one-time transition election the Board proposed that would allow entities to modify their current documentation of an existing hedge to change the subsequent assessment methodology from quantitative to qualitative. However, it is unclear to us whether an entity that did not make this election would be precluded from using a subsequent qualitative assessment for similar new hedge

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<sup>4</sup> Some may even believe that Entity A would be prohibited from hedging the variability in cash flows related to the total purchase price of the forecasted transaction because this could be viewed as hedging a derivative instrument, albeit one with a zero fair value. We do not hold this view because we believe the concept of a forecasted transaction can be considered separately from the contract that gives rise to the forecasted transaction as discussed in ASC 815-20-55-47 and 815-20-25-21 through 25-22.

relationships, without violating the guidance in ASC 815-20-35-2B. This guidance specifically states that the requirement that an entity assess effectiveness for similar hedges in a similar manner in accordance with paragraph 815-20-25-81 applies to an entity's selection of hedging relationships for which qualitative assessments are elected. In addition, paragraph BC168 in the proposal states that allowing this one-time transition election "would ensure that similar hedging relationships are assessed for effectiveness in accordance with paragraph 815-20-25-81."

In our view, subsequent hedge effectiveness assessments on a qualitative basis should be permitted for hedge relationships entered into after the adoption of the Proposed Update, even if an entity elects not to change its current assessment approach for similar existing hedge relationships upon adoption of the Proposed Update.

#### ***4) Non-zero fair value of hedging derivative at inception of a cash flow hedge***

Paragraph 815-30-35-41A notes that 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 hedge relationship. The proposed guidance goes on to state that 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."

We recommend that the Board clarify how the phrase in bold above relates to non-option derivatives because it is not clear to us exactly what amounts this phrase refers to. We believe the Board intended to refer to the difference between the non-zero fair value of the hedging derivative at hedge inception (based on discounted expected future cash flows) and the undiscounted expected future cash flows that correspond to this non-zero fair value. The difference between these two amounts represents the financing component of the non-zero fair value derivative, which results in ineffectiveness under existing US GAAP. Absent clarification, it is not clear that this is what the Board intended.

Accounting for non-option hedging instruments with fair values other than zero at the inception of a cash flow hedge relationship is an area that causes significant confusion in practice. Therefore, we recommend that the Board provide an example illustrating how the guidance in paragraph 815-30-35-41A would be applied when a non-option hedging derivative has a fair value other than zero at the inception of a cash flow hedge. Absent such an example, we are concerned that this will remain an area of confusion for many constituents and could result in the proposed guidance being misapplied.

#### ***5) Fair value hedges of interest rate risk using benchmark cash flows***

As discussed in our response to Question 3, we agree with the Board's decision to allow entities to use the cash flows associated with the benchmark rate determined at hedge inception in calculating the change in fair value of the hedged item attributable to interest rate risk.

However, we have concerns that the examples provided by the Board to illustrate the computations under such an approach may be misleading to constituents. This is because the Board provides two examples that both appear to result in a perfect offset between the change in fair value of the hedging

derivative and the hedged item despite using two distinct methodologies to compute the change in fair value of the hedged item:

- ▶ Case B in example 9 (815-25-55-61A through 55-61C) illustrates that the hedge can be perfectly effective using what is frequently referred to as the "120C method"
- ▶ Case B in example 16 (815-25-55-106 through 55-108) illustrates that hedge can be perfectly effective using what is frequently referred to as the "138 method"

It is not intuitive that both methods would give you a perfect offset in periods other than the first assessment period. Instead, we believe use of these different methods would result in a different adjustment to the hedged item because in subsequent periods, the beginning cash flows used in the "138" and "120C" method will differ. Given that the change in the fair value of the hedging derivative would be the same under each method, both should not result in a perfect offset.

We recommend that the Board consider expanding these two examples beyond the initial period to illustrate the different results that would occur under these methodologies.

#### **6) *Critical terms match and subsequent qualitative assessment of hedge effectiveness***

The Proposed Update would allow an entity to switch to the long-haul method of hedge accounting if it inappropriately used the shortcut method, as long as the entity documented at the inception of the hedge the methodology to be used if needed and the hedge is highly effective when this methodology is applied.

In addition, the proposal addresses how the guidance on error corrections in ASC 250 would be applied in each prior period in which an entity determines that the use of the shortcut method was not appropriate as follows:

- ▶ In those periods where hedge accounting could be continued after the shortcut criteria ceased to be met, the entity would apply the guidance in ASC 250 to the difference, if any, between the results recorded from applying the shortcut method and the quantitative long haul method documented at the inception of the hedge.
- ▶ In those periods where hedge accounting cannot be continued after the shortcut criteria ceased to be met, the entity would apply the guidance in ASC 250 to the difference between the results recorded from applying the shortcut method and the results of not applying hedge accounting.

In paragraph BC135 of the Proposed Update, the Board indicates its belief that "its decision on error corrections related to the shortcut method also should apply to the critical terms match method and the proposed guidance on subsequent qualitative assessments of hedge effectiveness after an initial quantitative test at hedge inception."

While we agree with the view expressed by the Board in paragraph BC135, we believe this guidance needs to be captured in the body of the FASB's proposal, not just in the Basis for Conclusions that will not be codified.

### **7) *Partial-term fair value hedges of interest rate risk***

Paragraph 815-25-35-13B in the Proposed Update states that an entity may measure the change in fair value of the hedged item in a partial-term fair value hedge of interest rate risk using an assumed term that begins with the “first hedged cash flow and ends with the last hedged cash flow.”

We find the phrase “first hedged cash flow” to be confusing as it could be interpreted to mean that an entity would be precluded from specifying the assumed term of the hedged item as beginning any time prior to the date the first hedged cash flow occurs (e.g., as of the date the first hedged cash flow begins to accrue). Given that it is common for fair value hedges of interest rate risk to begin when the hedged item is issued, we do not believe this interpretation is consistent with the Board’s intention.

To avoid confusion, we recommend the Board clarify this language to make the assumed starting point of the hedged item clearer.

### **Additional issues to be considered for inclusion in the Proposed Update**

#### **8) *Forecasted issuance of foreign denominated debt***

When foreign currency markets are volatile, entities that plan to issue foreign denominated debt may execute risk management strategies intended to mitigate their exposure to changes in foreign exchange rates prior to the debt issuance. Questions continue to arise in practice about whether such strategies qualify for hedge accounting treatment under ASC 815.

In December 2006, the DIG drafted tentative guidance to address this question in the form of DIG Issue H17, *Foreign Currency Hedges: Hedging Functional-Currency-Equivalent Proceeds to Be Received from a Forecasted Foreign-Currency Denominated Debt Issuance*. Although never issued, the draft DIG Issue tentatively concluded that these forecasted transactions were not eligible for designation as the hedged item in a cash flow hedge of foreign currency risk.

The DIG’s rationale was that the forecasted transaction did not represent an exposure to variations in cash flows that would affect earnings as required by ASC 815-20-25-15c2. However, the tentative DIG Issue offered alternative views from three dissenting Board members who believed that these forecasted transactions did present an exposure to variations in cash flows that could affect reported earnings. A number of constituents shared this view.

According to FASB meetings minutes, the Board decided against finalizing this DIG Issue, in part, because it believed the issue would be better addressed in a possible broader derivatives and hedging project like the current project. We therefore believe the Board should consider addressing this issue in its current proposal or have the Emerging Issues Task Force address it.

**9) *Consideration of a range in the initial quantitative assessment of hedge effectiveness***

In order to qualify for cash flow hedge accounting, a forecasted transaction must be probable and the hedging relationship must be expected to be highly effective (both at inception of the hedge and on an ongoing basis) in achieving offsetting cash flows attributable to the hedged risk. In addition, ASC 815-20-25-3d requires that documentation of a cash flow hedging relationship specify either the date on or period in which the forecasted transaction is expected to occur.

For forecasted transactions whose timing involves some uncertainty, ASC 815-20-25-16c notes that a range could be documented as the originally specified time period, provided that 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.

While this guidance is clear that the period within which the forecasted transaction is expected to occur may be documented as a range, and this range is considered when assessing whether the forecasted transaction is deemed probable to occur, there is diversity in thought regarding whether that range would also need to be considered when assessing whether the relationship is expected to be highly effective.

Some believe that the key pillars of cash flow hedge accounting – that the forecasted transaction be probable of occurring within the specified time frame and that the hedge relationship is expected to be highly effective – should be assessed in a consistent manner such that the hedge relationship should be expected to be effective if it occurs at any point within the specified range.

Those who hold this view think that the timing uncertainty that led to the designation of a range should be considered when assessing effectiveness, and therefore believe an analysis should be performed to determine whether the hedge would be highly effective if the forecasted transaction occurred at either the beginning or end of the range. Without such an analysis, there is a concern that the documented range could be so large that it would be unlikely that the forecasted transaction would occur outside the range. While the hedge may still need to be redesignated based on changes to the best estimate of timing, any amounts previously recognized in AOCI would not be released until the forecasted transaction affects earnings, as it would still occur within the documented range.

Others look to the guidance in ASC 825-20-25-16d, which states that, while documenting the period within which the forecasted transaction will occur is sufficient to comply with the requirements of ASC 815-20-25-3, the best estimate of the forecasted transaction's timing must be both documented and used in assessing hedge effectiveness. Those who hold this view believe that this guidance, along with the example in paragraphs 815-20-55-101 through 55-104, indicate that the assessment of hedge effectiveness need only consider the best estimate of timing.

We believe the Board should consider clarifying this issue in the Proposed Update. While diversity in practice exists under current US GAAP, we believe this issue has the potential to become even more important, given the Board's proposal to eliminate the requirement to separately measure and report ineffectiveness. As a result of this decision, the Proposed Update would eliminate the guidance in paragraph 815-20-55-104 that requires entities to perform a final measurement when a hedge is no longer deemed to be highly effective in order to effectively "true-up" the amount deferred in AOCI based on the change in the best estimate of timing that led to the hedge no longer being highly effective.