MINUTES

FINANCIAL ACCOUNTING STANDARDS BOARD

MEMORANDUM

To:	Board Members		
From:	Accounting for Financial Instruments Team		
Subject:	Minutes of March 28, 2018 Board Meeting	**Date:**	April 4, 2018

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue an Accounting Standards Update or a Statement of Financial Accounting Concepts.

Topic: Financial Instruments—Hedging Implementation

Basis for Discussion: FASB Memo No. 40, *Implementation Questions*

Length of Discussion: 9:50 a.m. to 10:50 a.m. EDT

Attendance:

Board members present:	Golden, Kroeker, Botosan, Hunt, Schroeder (phone), and Siegel
Board members absent:	Monk
Staff in charge of topic:	Gabello
Other staff at Board table:	Cosper, Kuhaneck, Um, Sangiuolo, Cline, and LaFrano
Outside participants:	None

<u>Type of Document and Timing Based on the Technical Plan</u>:

The Board met to discuss issues relating to the implementation of Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities.*

<u>Tentative Board Decisions</u>:

The Board discussed the status of and issues arising from implementation activities related to Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The Board discussed the staff's response to:

1. Technical inquiries received related to designating the hedged risk as the variability of a contractually specified component in the forecasted purchase or sale of a nonfinancial asset in a cash flow hedge. Specifically, the staff presented its interpretation of the guidance on the contractually specified components model, noting the following:

    a. All contracts must be analyzed under the guidance in paragraphs 815-20-25-22A through 25-22B for an entity to be able to designate the variability in a contractually specified component as the hedged risk in a cash flow hedge. Paragraph 815-20-25-22B states that an entity may designate the variability of a contractually specified component in a not-yet-existing contract if at hedge inception the entity expects that the contract will meet the requirements in paragraph 815-20-25-22A when the contract is issued. When the contract is entered into, the entity must then perform the analysis required by paragraph 815-20-25-22A. The guidance in those paragraphs also applies when the contractually specified component is explicitly referenced in documents other than a contract (for example, supporting agreements to a contract or purchases or sales receipts in spot purchase).

    b. If an entity does not have a contract at hedge inception, it must develop an expectation (for example, through previous experience) that when the transaction is entered into:

        i. The written agreement for a forecasted purchase or sale will contain an explicitly referenced contractually specified component.

        ii. The pricing formula that references the explicitly referenced contractually specified component will determine the price of the nonfinancial item.

        iii. The requirements for cash flow hedge accounting will be met.

        iv. The agreement will be substantive.

The staff noted that setting those expectations will require judgment. However, for transactions in which an entity has previous experience, it may be easier to set those expectations than for transactions in which the entity does not have previous experience.

The Board agreed with the staff's conclusions. The staff will form a project resource group to monitor implementation in this area, and other areas if needed.

2. Technical inquiries received on multiple partial-term hedges of a single financial instrument. The staff presented its interpretation of the guidance related to the partial-term hedging election. Specifically, the staff noted that the partial-term fair value hedging guidance in 815-20-25-12(b)(2)(ii), as amended by Update 2017-12, should be applicable to simultaneous multiple partial-term hedging relationships for a single debt instrument (for example, consecutive interest cash flows in Years 1–3 and consecutive cash flows in Years 5–7 of a 10-year bond). However, this conclusion should not be analogized to the last-of-layer method until further research is conducted on hedging multiple layers. The Board agreed with the staff's conclusions.

3. Technical inquiries received related to accounting for basis adjustments and hedging multiple layers under the last-of-layer method. The Board decided to add a narrow-scope project to the agenda to address issues related to accounting for basis adjustments (Vote: 7-0; 1 Board member voted by proxy) and multiple-layer hedging strategies (Vote: 5-2; 1 Board member voted by proxy). The Board decided at this time not to include in that project an expansion of the last-of-layer method to include prepayable liabilities and nonprepayable financial instruments. (Vote: 6-1; 1 Board member voted by proxy)

4. Technical inquiries received related to the change in hedged risk concept in paragraph 815-30-35-37A. That paragraph allows an entity to retain hedge accounting when the hedged risk in a cash flow hedge changes and the derivative designated as the hedging instrument remains highly effective. The staff presented feedback from those inquiries and potential Codification improvements to address the issues raised. Those improvements could include clarifications that:

    a. The hedged forecasted transaction and hedged risk are distinct.

    b. The hedged risk may change, and an entity may retain hedge accounting if the revised hedging relationship is highly effective even if a distinction is not made between the hedged forecasted transaction and the hedged risk in an entity's hedge documentation.

c. The hedged forecasted transaction may not be documented so broadly such that if a change in hedged risk occurs, it does not share the same risk exposure as the originally designated hedged forecasted transaction.

d. If the hedging relationship based on the revised hedged risk is not highly effective, the entity must cease hedge accounting but amounts previously recorded in accumulated other comprehensive income remain until the hedged forecasted transaction affects earnings if the forecasted transaction is still probable of occurring. That wording already is included in Example 9 of Subtopic 815-30 but may be added to other sections of that Subtopic.

e. Hindsight may be applied in identifying transactions as hedged transactions. However, an entity must first identify transactions as hedged transactions based on the originally documented hedged risk. Only when there are no transactions or insufficient transactions based on the originally documented hedged risk may the entity consider transactions based on other risks. If a transaction occurred in a prior reporting period, it may be retrospectively identified as a hedged transaction if it has not yet affected reported earnings.

The Board directed the staff to get external review feedback on these potential Codification improvements. (Vote: 7-0; 1 Board member voted by proxy)

Next Steps

See next steps discussed above.

General Announcements: None