

SEC Staff Discussion at the March 15, 2007 EITF Meeting

"Application of the 'Critical Terms Match' Approach"

An SEC staff member discussed the application of the "critical terms match" approach to applying hedge accounting for cash flow hedges under paragraph 65 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In recent discussions regarding hedge accounting for foreign currency and commodity relationships, the SEC staff has become aware that in certain instances registrants have assumed no ineffectiveness in a hedging relationship when applying critical terms match in situations in which certain terms of the hedge and the hedged item may be different.

An SEC staff member indicated that in situations in which registrants have applied the critical terms match method when the terms of the hedge and the hedged item do not exactly match, but the other provisions of paragraph 65 have been satisfied, registrants would generally be expected to:

- a. Evaluate and support the reasonableness of the original conclusion that the terms of the hedge and the hedged item matched¹
- b. Perform a quantitative assessment to confirm that the relationship was highly effective and that any ineffectiveness was de minimis.

If the results confirm that there was a reasonable basis to assert that the terms matched, that the relationship was highly effective, and that any ineffectiveness was de minimis, continued application of hedge accounting may be acceptable. For situations in which registrants assumed no ineffectiveness, but for which there was not a reasonable basis to assert that the terms matched, that the relationships were not highly effective, or that the ineffectiveness was not de minimis, the SEC staff member indicated that registrants may want to discuss the matter with the SEC's Office of the Chief Accountant.

¹ One example might be a foreign currency hedging relationship in which the settlement of the forecasted transaction and the derivative occurred within the same month but on different days.