FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: November 12, 2019
Comments Due: January 13, 2020

Derivatives and Hedging (Topic 815)

Codification Improvements to Hedge Accounting

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 815 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2019-790, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until January 13, 2020. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2019-790
- Sending a letter to "Technical Director, File Reference No. 2019-790, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

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. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

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Codification Improvements to Hedge Accounting

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CONTENTS

Page Numbers

Summary and Questions for Respondents..1–8
Amendments to the *FASB Accounting Standards Codification*® 9–83
Background Information and Basis for Conclusions....................................84–114
Amendments to the XBRL Taxonomy 115

Summary and Questions for Respondents

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

On August 28, 2017, the FASB issued Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*. The amendments in that Update made targeted improvements to the hedge accounting model 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 primary objective, the amendments in that Update made certain targeted improvements to simplify the application of hedge accounting guidance in current generally accepted accounting principles (GAAP) on the basis of the feedback received from preparers, auditors, users, and other stakeholders.

Since the issuance of Update 2017-12, the Board has assisted stakeholders in the implementation of the amendments in that Update. Through this interaction with stakeholders, the Board has identified certain areas that require clarification to better align those areas with the objective articulated in Update 2017-12.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to any entity that elects to apply hedge accounting in accordance with Topic 815.

What Are the Main Provisions?

Issue 1: Change in Hedged Risk in a Cash Flow Hedge

Area for Improvement	Summary of Proposed Amendments
The change in hedged risk guidance added in paragraph 815-30-35-37A has resulted in uncertainty about when an entity should apply the missed forecast guidance in accordance with paragraphs 815-30-40-4 through 40-6.	The proposed amendments would clarify that the forecasted transaction and hedged risk are distinct. Thus, the forecasted transaction, not the hedged risk, would be relevant in the application of the missed forecast guidance in accordance with paragraphs 815-30-40-4 through 40-6.

Area for Improvement	Summary of Proposed Amendments
With the clarification that the forecasted transaction and hedged risk are distinct, additional clarity is needed on what criteria must be applied to: a. Designate the hedged risk b. Identify forecasted transactions when they occur.	The proposed amendments would clarify that: a. The designated hedged risk should represent an entity's best estimate of the hedged risk expected to cause variability in the cash flows associated with the forecasted transaction. b. The forecasted transaction must be documented with sufficient specificity such that an entity can identify a transaction that is eligible to be identified as hedged when it occurs, regardless of the hedged risk.
Additional clarity is needed on how designating a best estimate of the hedged risk interacts with the guidance to: a. Assess effectiveness b. Determine whether the forecasted transactions hedged in a group share the risk exposure for which they are being hedged.	The proposed amendments would clarify that: a. An entity should assess effectiveness using its then-best estimate of the hedged risk. The entity should not revise previous assessments of effectiveness if there are subsequent changes in its best estimate of the hedged risk. b. Forecasted transactions hedged in a group should share the risk exposure for which they are being hedged at hedge inception and prospectively on an ongoing basis based on the entity's then-best estimate of the hedged risk.
The change in hedged risk guidance does not indicate whether certain types of cash flow hedging relationships are excluded from the scope of the guidance.	The proposed amendments would clarify that hedges of foreign exchange risk and hedges of credit risk are excluded from the scope of the change in hedged risk guidance.

Issue 2: Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions

Area for Improvement	Summary of Proposed Amendments
Additional clarity is needed on the nature of the documentation that may evidence a contractually specified component.	The proposed amendments would clarify the nature of the documentation that may evidence a contractually specified component. The proposed amendments would clarify that such documentation could include a supply arrangement, ancillary or side agreement, governing agreement of a transaction, or a purchase or sale agreement accounted for as a derivative under Topic 815 that meets the criteria in paragraph 815-20-25-15B, a spot purchase receipt, or other documentation that supports the price at which a nonfinancial asset is purchased or sold.
Additional clarity is needed on when the documentation evidencing a contractually specified component must be obtained to designate the variability in a contractually specified component as the hedged risk in a cash flow hedge.	The proposed amendments would clarify that an entity may designate the variability in a contractually specified component as the hedged risk in a cash flow hedge of a forecasted transaction regardless of whether the documentation explicitly referencing the contractually specified component is obtained before or after the forecasted transaction occurs. The proposed amendments would clarify that an entity may base its expectation that a contractually specified component will be explicitly referenced on prior experience with similar transactions.
Additional clarity is needed on whether an entity must apply the normal purchases and normal sales scope exception to a forecasted transaction to be eligible for contractually specified component	The proposed amendments would clarify that for forecasted transactions that qualify for cash flow hedging and contractually specified components that qualify for contractually specified component risk hedging an entity would need to apply only the portion of

Area for Improvement	Summary of Proposed Amendments
risk hedging.	the normal purchases and normal sales scope exception that requires all underlyings in the agreement to be clearly and closely related to the asset being sold or purchased.
Additional clarity is needed on how an entity should support that a contractually specified component determines the price of the nonfinancial asset.	For non-spot-market transactions, the proposed amendments would clarify that the pricing formula that includes the contractually specified component must determine the price of the nonfinancial asset but would prescribe no specific method to satisfy that requirement. For spot-market transactions, the pricing formula that includes the contractually specified component must be based on how the price is determined in that nonfinancial asset's spot market.
Additional clarity is needed on whether a forecasted purchase or sale of a nonfinancial asset accounted for as a derivative may be eligible as a forecasted transaction in a cash flow hedge of either the variability of the overall price changes or the variability in a contractually specified component.	The proposed amendments would clarify that a purchase or sale of a nonfinancial asset accounted for as a derivative may be designated as the forecasted transaction in a cash flow hedge of either the variability of the overall price changes or the variability in a contractually specified component if physical settlement of the contract accounted for as a derivative is probable and the forecasted transaction is not the acquisition of a nonfinancial asset that will subsequently be remeasured with changes in fair value attributable to the hedged risk reported in earnings.

Issue 3: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

Area for Improvement	Summary of Proposed Amendments
A dual hedge is one in which a foreign-currency-denominated debt instrument is designated as the hedging instrument in a hedge of a net investment in a foreign entity and the hedged item in a fair value hedge of interest rate risk designated in accordance with paragraph 815-20-55-38. Stakeholders indicated that a recognition and presentation mismatch for the dual hedging strategy was created by the amendments in paragraph 815-20-55-129. As a result, stakeholders indicated that the economics of the hedging strategy is not accurately reflected under hedge accounting. The mismatch resulted from the deferral of the foreign exchange remeasurement of the fair value hedge basis adjustment in accumulated other comprehensive income.	The proposed amendments would eliminate the recognition and presentation mismatch related to dual hedges caused by the amendments in Update 2017-12. The proposed amendments would eliminate that mismatch by requiring that an entity exclude the foreign-currency-denominated debt instrument's fair value hedge basis adjustment from the net investment hedge effectiveness assessment. As a result, the gains and losses from the remeasurement of the debt instrument's fair value hedge basis adjustment at the spot exchange rate would immediately be recognized in earnings.

Issue 4: Using the Term *Prepayable* under the Shortcut Method

Area for Improvement	Summary of Proposed Amendments
As a result of amendments in Update 2017-12, the term *prepayable* is used in two areas of Subtopic 815-20, Derivatives and Hedging—Hedging—General, with a different meaning in each area. The term is used both to describe the scope of the guidance for hedging interest rate risk of prepayable financial assets and to	To clarify that different meanings are intended, the proposed amendments would replace *prepayable* with *early settlement feature* for the purposes of applying the shortcut method.

Area for Improvement	Summary of Proposed Amendments
describe when a mirror-image call or put option is required in a derivative designated as the hedging instrument in a hedge of a prepayable financial asset under the shortcut method.	

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

The amendments in this proposed Update represent changes to clarify or improve the Codification. The proposed amendments would make the Codification easier to understand and apply by eliminating inconsistencies and providing clarifications.

When Would the Amendments Be Effective and What Are the Transition Requirements?

The proposed amendments would be effective for all entities for fiscal years beginning after December 15, 2020. For public business entities, the proposed amendments would be effective for interim periods within fiscal years beginning after December 15, 2020. For all other entities, the proposed amendments would be effective for interim periods within fiscal years beginning after December 15, 2021. Early adoption would be permitted for all entities on any date on or after issuance of a final Update if an entity already has adopted the amendments in Update 2017-12.

Entities that adopt the amendments in Update 2017-12 on the same date as a final Update on the amendments in this proposed Update would apply the same transition method for both Updates. For example, the transition provisions in Update 2017-12 related to contractually specified component hedging would apply to the amendments related to contractually specified component hedging in this proposed Update.

Entities that have adopted the amendments in Update 2017-12 as of the adoption date of a final Update of the amendments in this proposed Update would be permitted to apply the proposed amendments on a prospective basis from the date of adoption or on a retrospective basis to the date of adoption of the amendments in Update 2017-12 with certain exceptions.

All entities, regardless of transition method, would be required to amend their hedge documentation at the date of adoption of a final Update for existing hedges within the scope of the change in hedged risk guidance, without dedesignation, to include the method to be used to identify a hedged transaction using hindsight.

An entity may make certain transition elections upon adoption of the proposed amendments. See paragraph 815-20-65-6 for additional details about those elections.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do the amendments in this proposed Update clarify and improve the guidance in Topic 815? If not, please explain which proposed amendment or amendments do not clarify and improve the guidance and why.

Question 2: Are the proposed amendments operable? If not, which proposed amendment or amendments pose operability issues and why?

Question 3: Should other changes related to the proposed amendments be made to clarify the intent of the proposed amendments?

Question 4: Would any of the proposed amendments require special consideration for private companies that are not financial institutions and not-for-profit entities (except for not-for-profits 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)? If so, which proposed amendment or amendments would require special consideration and why?

Question 5: Should entities use a method documented at hedge inception to identify hedged transactions using hindsight or should another approach be used? Please explain why. If you support another approach, please explain that alternative.

Question 6: Is transition guidance needed for entities that may have applied the change in hedge risk guidance to hedges of foreign exchange risk or credit risk or both in reported financial statements?

Question 7: Do you agree with the specific considerations for transition for the proposed amendments? Are other transition provisions needed related to:

a. The proposed amendments that would require that an entity consider only the designated hedged risk in the prospective assessment of hedge effectiveness for hedges within the scope of the change in hedged risk guidance

b. The proposed amendments on the subsequent assessment of hedge effectiveness when a change in hedged risk is identified?

Please explain why or why not.

Question 8: Do you agree with the proposed effective dates? If the proposed amendments were effective for all public business entities for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years and for all other entities for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021, would entities have sufficient time to implement these amendments if a final Update is issued in the first half of 2020?

Amendments to the *FASB Accounting Standards Codification*®

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Subtopic	**Description of Changes**
Subtopic 815-20, Derivatives and Hedging—Hedging—General	Issue 1: Change in Hedged Risk in a Cash Flow Hedge • Amended the documentation requirements to indicate that an entity would document its best estimate of the hedged risk expected to cause the variability in cash flows in the forecasted transaction when it occurs • Added guidance on designating a method of identifying a hedged transaction with an undocumented hedged risk after it occurred • Amended guidance on the prospective assessment of hedge effectiveness for cash flow hedges • Added the requirement that forecasted transactions hedged in a group with a single hedging instrument prospectively share the same risk exposure for which they are hedged • Amended implementation guidance to indicate that shared risk exposure should be assessed for forecasted transactions prospectively if an entity identifies a change in hedged risk • Consequential amendments to Examples 4 and 22 • Amended the scope of the change in hedged risk guidance to exclude hedges of foreign exchange risk and hedges of credit risk.

Codification Subtopic	Description of Changes
	Issue 2: Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions • Added guidance to allow a forecasted transaction to purchase or sell a nonfinancial asset under a contract accounted for as a derivative to be designated as a forecasted transaction in a cash flow hedge if certain criteria are met • Reordered and amended guidance on the designation of a contractually specified component as the hedged risk in a forecasted purchase or sale of a nonfinancial asset. Issue 3: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge) • Amended implementation guidance on dual hedges to require that an entity exclude from the assessment of effectiveness in the net investment hedging relationship the fair value hedge basis adjustment resulting from designating the foreign-currency-denominated debt instrument in the fair value hedge • Amended Example 10 to illustrate the new dual hedge effectiveness testing requirements. Issue 4: Using the Term *Prepayable* under the Shortcut Method • Amended the shortcut method guidance to replace the term *prepayable* with *early settlement feature.*
Subtopic 815-30, Derivatives and Hedging—Cash Flow Hedges	Issue 1: Change in Hedged Risk in a Cash Flow Hedge • Added guidance on the assessment of hedge effectiveness if a change in hedged risk is identified • Amended change in hedged risk guidance when the change is identified before the forecasted transaction occurs

Codification Subtopic	Description of Changes
	• Added change in hedged risk guidance when the change is identified after the forecasted transaction occurs • Added guidance addressing situations in which the method of identifying a hedged transaction with an undocumented hedged risk changes after hedge inception • Amended and added change in hedged risk implementation guidance • Consequential amendments to Examples 9 and 16 • Added Examples 24 through 26 on the application of change in hedged risk guidance. Issue 2: Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions • Consequential amendments.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–17. 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~~.

Issue 1: Change in Hedged Risk in a Cash Flow Hedge

3. The proposed amendments would clarify that:

   a. The forecasted transaction and hedged risk are distinct. Thus, the forecasted transaction, not the hedged risk, would be relevant in the application of the missed forecast guidance in accordance with paragraph 815-30-40-5.
   b. The designated hedged risk should represent an entity's best estimate of the hedged risk expected to cause variability in the cash flows associated with the forecasted transaction.

c. The forecasted transaction must be documented with sufficient specificity such that an entity can identify a transaction that is eligible to be identified as hedged when it occurs, regardless of the hedged risk.
d. Each period an entity should assess hedge effectiveness using its then-best estimate of the hedged risk. An entity should not revise previous assessments of hedge effectiveness if there are subsequent changes in its best estimate of the hedged risk. If an entity identifies that the hedged risk has changed, it should begin assessing hedge effectiveness using the revised hedged risk as of the date that the change was identified. If an entity identifies a change in hedged risk using hindsight, the entity would not retrospectively assess effectiveness with the revised hedged risk because the revised hedged risk was not its then-best estimate for the historical period. In that situation, if the forecasted transaction occurred, the entity would not apply the missed forecast guidance.
e. Forecasted transactions hedged in a group should share the risk exposure for which they are being hedged at hedge inception and prospectively on an ongoing basis based on an entity's then-best estimate of the hedged risk. If an entity identifies that the hedged risk associated with one or more forecasted transactions included in the group has changed, hedge accounting may continue if the forecasted transactions at the date the change is identified prospectively share the risk exposure for which they are being hedged and all other criteria to apply cash flow hedge accounting continue to be met. If the change in hedged risk is identified using hindsight, the entity would not retrospectively assess whether hedged transactions share the risk exposure for which they were hedged because the transactions already occurred when the change was identified.
f. Hedges of foreign exchange risk and hedges of credit risk are excluded from the scope of the change in hedged risk guidance.

Amendments to Subtopic 815-20

4. Amend paragraphs 815-20-25-3(d), 815-20-25-16(c), and 815-20-25-19A(b), and 815-20-25-79, supersede paragraph 815-20-25-19B, and add paragraph 815-20-25-22F and its related heading and 815-20-25-79B, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> 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 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:

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 <u>(see paragraphs 815-30-55-1G through 55-1V for related implementation guidance)</u>:
      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 <u>eligible to be identified as</u> the hedged transaction <u>regardless of the hedged risk</u>. 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 <u>best estimate of the</u> contractually specified component <u>that is expected to cause the variability in cash flows</u>

in the forecasted purchase or sale of a nonfinancial asset when it occurs.

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 best estimate of the contractually specified interest rate that is expected to cause the variability in cash flows in the forecasted interest receipts or payments when they occur.

ix. The method that will be used to identify a hedged transaction with an undocumented hedged risk after it occurred if applying the guidance in paragraph 815-30-35-37C.

> > > 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):

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 <u>eligible to be identified as</u> the hedged transaction <u>regardless of the hedged risk</u>. 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.

> Eligibility of Hedged Items and Transactions

> > Hedged Transaction Criteria Applicable to Cash Flow Hedges Only

> > > Forecasted Issuances or Purchases of Debt Instruments

815-20-25-17 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.

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 its best estimate of the contractually specified interest rate expected to cause variability in the forecasted transaction when it occurs as the hedged risk.

815-20-25-19B Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~

> > > Method of Identifying a Hedged Transaction with an Undocumented Hedged Risk after It Occurred

815-20-25-22F This Subtopic does not specify a single method that should be used to identify a transaction as the hedged forecasted transaction based on an undocumented hedged risk when applying the guidance in paragraph 815-30-35-37C. The method used shall be reasonable. Similar to an entity's method for assessing hedge effectiveness in accordance with paragraph 815-20-25-81, the appropriateness of the method used to identify a transaction as the hedged forecasted transaction after it occurred depends on the nature of the hedging relationship. Ordinarily, an entity shall apply a similar identification method for similar hedges. Use of different methods for similar hedges shall be justified. The method shall be applied only if the entity identifies a transaction as the hedged forecasted transaction after the forecasted transaction occurred as a result of a change in hedged risk.

> Hedge Effectiveness

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

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. Except as described in paragraph 815-20-25-79B, the ~~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 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 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 for further guidance. <u>See paragraph 815-30-35-1B for further guidance on retrospective effectiveness assessment for cash flow hedges within the scope of the change in hedged risk guidance in paragraphs 815-30-35-37A through 35-37C.</u>

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).

<u>**815-20-25-79B** For a cash flow hedge of a risk that may be designated in accordance with paragraph 815-20-25-15(i) or (j) (except for foreign exchange risk designated in accordance with paragraph 815-20-25-15(i)(1) or (j)(3) and credit risk designated in accordance with paragraph 815-20-25-15(j)(4)), the quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in cash flows of the forecasted transaction attributable to the designated hedged risk. An entity shall not consider possible changes in cash flows of the forecasted transaction attributable to a risk or risks other than the designated hedged risk. The quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in cash flows of the derivative instrument in accordance with paragraph 815-20-25-79(a).</u>

5. Amend paragraphs 815-20-55-20, 815-20-55-23, 815-20-55-26, 815-20-55-56, 815-20-55-93, and 815-20-55-197 and add paragraphs 815-20-55-23A through 55-23B, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Eligibility of Hedged Items

> > > Hedged Items in Cash Flow Hedges Only

> > > > 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 eligible to be identified as 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 ~~At the time of hedge designation only~~ However, the transactions in each group must prospectively share the risk exposure for which they are being hedged. If an entity identifies that the hedged risk associated with one or more forecasted transactions included in the group has changed in accordance with paragraph 815-30-35-37A, hedge accounting may continue if at the date the change is identified the forecasted transactions prospectively share the risk exposure for which they are being hedged and all other criteria to apply cash flow hedge accounting continue to be met. For example, at hedge inception all of the forecasted interest payments in the group in (c) in ~~the preceding~~ paragraph 815-20-55-22 ~~shall~~ are expected to vary with the same contractually specified interest rate ~~index to qualify for hedging~~ based on an entity's best estimate of the hedged risk, but subsequently all or a portion of the forecasted interest payments in the group change to vary with a different contractually specified interest rate. In that circumstance, hedge accounting may continue with a single derivative instrument if at the date the change is identified the forecasted transactions prospectively share the risk exposure for which they are being hedged. If at the date the change in hedged risk is identified the forecasted transactions prospectively do not share the risk exposure for which they are being hedged, hedge accounting should be discontinued or partially discontinued such that the hedged forecasted transactions in the group prospectively share the risk exposure for which they are being hedged.

815-20-55-23A When assessing whether forecasted transactions hedged in a group share the risk exposure for which they are being hedged, an entity should determine its best estimate of the hedged risk for each individual forecasted transaction included in the group rather than its best estimate for the portfolio as a whole. It would be inappropriate for an entity to assume that its best estimate of the hedged risk for the majority of forecasted transactions in the portfolio applies to all forecasted transactions in the group.

815-20-55-23B Paragraphs 815-30-35-37A through 35-37E, paragraphs 815-30-55-1G through 55-1V, and Examples 24 through 26 in paragraphs 815-30-55-149 through 55-169 provide additional guidance on a change in the designated hedged risk for a forecasted transaction, including aggregated forecasted transactions.

> > > > 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 eligible to be identified as 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.

> > Hedge Effectiveness

> > > Changes in Quantitative Assessment Methods

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~~ paragraphs 815-30-35-37A and 815-30-35-37D, a change to the hedged risk in a cash flow hedge of a forecasted ~~transaction~~ transaction, except for hedges of foreign exchange risk designated in accordance with paragraph 815-20-25-15(i)(1) or (j)(3) and credit risk designated in accordance with paragraph 815-20-25-15(j)(4), 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.

> Illustrations

> > 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).

> > > 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 <u>eligible to be identified as</u> 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 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 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.

> > 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 effect of the embedded call option (Case A) or the effect of the interest rate cap (Case B). As required by paragraph 815-20-25-6, 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 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. In the case of a cash flow hedge of variable interest payments associated with debt with an embedded cap discussed in Case B, in accordance with paragraph 815-20-25-79B, Entity A should assess hedge effectiveness on the basis of whether the cap will be exceeded because of variability in Entity A's best estimate of the hedged risk (that is, only because of variability in six-month LIBOR). Risks that were not designated as hedged should not be considered in Entity A's effectiveness assessment.

Amendments to Subtopic 815-30

6. Supersede paragraph 815-30-35-1, add paragraphs 815-30-35-1A through 35-1B and the related heading, 815-30-35-37B through 35-37E, and 815-30-35-45A and the related heading, and amend paragraphs 815-30-35-7 and 815-30-35-37A, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Cash Flow Hedges

Subsequent Measurement

815-30-35-1 Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~ **[Content amended and moved to paragraph 815-30-35-1A]**

815-30-35-1A The guidance in this Section is organized as follows:

a. Subsequent hedge effectiveness assessment for a cash flow hedge within the scope of the change in hedged risk guidance
b. ~~a.~~ Subsequent recognition and measurement of gains and losses on hedging instrument
c. ~~b.~~ Reclassifications from accumulated other comprehensive income into earnings
d. ~~c.~~ Hedging relationship's timing that involves uncertainty within a range. **[Content amended as shown and moved from paragraph 815-30-35-1]**

> Subsequent Hedge Effectiveness Assessment for a Cash Flow Hedge within the Scope of the Change in Hedged Risk Guidance

815-30-35-1B Each period an entity shall assess effectiveness for cash flow hedges within the scope of the change in hedged risk guidance in paragraphs 815-30-35-37A through 35-37C in accordance with paragraphs 815-20-25-79 and 815-20-25-79B using its then-best estimate of the hedged risk. The entity shall not revise previous assessments of effectiveness if there are subsequent changes in its best estimate of the hedged risk. If an entity identifies that the hedged risk has changed, it shall begin assessing hedge effectiveness as of the date that the change was identified using the revised hedged risk. All amounts recorded related to the hedging relationship before the date that the change in hedged risk was identified are not revised because of the change in hedged risk and, thus, shall not be adjusted as a result of the change. See paragraph 815-30-55-1Q for guidance on amending hedge documentation if a change in hedged risk is identified before the forecasted transaction occurs. See the guidance in paragraphs 815-30-55-1B through 55-1F and Example 9 (paragraphs 815-30-55-52 through 55-61) and Example 16 (paragraphs 815-30-55-94 through 55-98C), which illustrate the application of this paragraph.

> Subsequent Recognition and Measurement of Gains and Losses on Hedging Instrument

815-30-35-7 Examples 1 through 4 (see paragraphs ~~815-30-55-1A~~ 815-30-55-1W through 55-19) illustrate assessing hedge effectiveness. Example 10 (see paragraph 815-30-55-63) illustrates the application of paragraph 815-30-35-3.

> > Change in Designated Hedged Risk

815-30-35-37A For all risks that may be designated in accordance with paragraph 815-20-25-15(i) or (j), except for foreign exchange risk designated in accordance with paragraph 815-20-25-15(i)(1) or (j)(3) and credit risk designated in accordance with paragraph 815-20-25-15(j)(4), if ~~If~~ the designated hedged risk associated with the forecasted transaction changes ~~during the life of a hedging~~

~~relationship~~ before the hedged transaction occurs, an entity may continue to apply hedge accounting if the hedging instrument is expected to be highly effective at achieving offsetting cash flows attributable to the revised hedged risk in accordance with paragraph 815-30-35-1B and if all other criteria to apply cash flow hedge accounting continue to be met. Alternatively, if the hedging instrument is not expected to be highly effective at achieving offsetting cash flows attributable to the revised hedged risk in accordance with paragraph 815-30-35-1B, the entity shall discontinue hedge accounting as of the date that the change in hedged risk is identified. (See paragraph 815-30-55-1R for implementation guidance related to the assessment of hedge effectiveness.) In either circumstance, amounts recorded in accumulated other comprehensive income associated with a forecasted transaction with a revised risk shall be reclassified to earnings in accordance with paragraphs 815-30-35-38 through 35-41. Those amounts 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. As stated ~~The guidance~~ in paragraph 815-20-55-56, the guidance on automatic dedesignation if there is a change in a critical term of a hedging relationship does not apply to changes in the hedged risk for a cash flow hedge of a forecasted transaction as described in this paragraph.

815-30-35-37B An entity shall reevaluate its best estimate of the expected hedged risk at a minimum at each quarterly assessment period. An entity shall apply the guidance in paragraph 815-30-35-37A only if there is a shortfall in transactions with the designated hedged risk expected during the originally specified time period. The guidance in paragraph 815-30-35-37A shall be applied regardless of whether transactions with the designated hedged risk are expected to occur in the two-month period following the originally specified time period in accordance with paragraph 815-30-40-4. Example 24, Case A (see paragraphs 815-30-55-149 through 55-152) illustrates the application of this guidance. That Case demonstrates that an entity must identify all forecasted transactions eligible to be identified as hedged that are expected to occur in the originally specified period as hedged transactions (that is, considering all risks) before identifying any forecasted transactions expected to occur in the two-month period of time thereafter as hedged transactions.

815-30-35-37C For the same qualifying risks described in paragraph 815-30-35-37A, an entity may identify after the forecasted transaction occurred that there is a shortfall in transactions with the entity's best estimate of the hedged risk. In those circumstances, amounts recorded in accumulated other comprehensive income before the change in hedged risk was identified shall be associated with transactions that occurred with an undocumented hedged risk in accordance with the entity's method of identifying hedged transaction described in paragraph 815-20-25-3(d)(1)(ix). Those amounts shall be reclassified to 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 guidance in this paragraph shall be applied regardless of whether transactions with the designated hedged risk are expected to occur in the two-month period following the hedge period in accordance with paragraph 815-30-40-4. Example 24, Cases B and C (see paragraphs 815-30-55-153 through 55-157) and Example 26 (see paragraph 815-30-55-161) illustrate the application of this guidance. Those Cases demonstrate that an entity must identify all forecasted transactions eligible to be identified as hedged that occurred in the originally specified period as hedged transactions (that is, considering all risks) before identifying any forecasted transactions that occurred in the two-month period of time thereafter as hedged transactions.

815-30-35-37D For a cash flow hedge of interest rate risk, if the hedged risk changes as described in either paragraph 815-30-35-37A or 815-30-35-37C, the number and timing of the forecasted interest receipts or payments also may change within the hedge period. Those changes shall not be considered changes to the critical terms of the hedging relationship that require an automatic dedesignation of the hedging relationship. And, those changes would not result in an entity determining that the forecasted transactions are probable of not occurring. Therefore, the entity would not apply the guidance in paragraph 815-30-40-5. Instead, in those circumstances, an entity shall apply the guidance in paragraph 815-30-35-37A and may continue to apply hedge accounting if the hedging instrument is expected to be a highly effective hedge of the forecasted interest receipts or payments with the revised risk, frequency, and timing in accordance with paragraph 815-30-35-1B and if all other criteria to apply cash flow hedge accounting continue to be met. If the change in hedged risk is identified after the forecasted interest receipts or payments occurred and an entity is applying the guidance in paragraph 815-30-35-37C, the entity may identify interest receipts or payments as hedged if the number or timing of the transactions differed from that initially documented if the receipts or payments still occurred within the hedge period. If the timing of a forecasted interest receipt or payment changes such that it is no longer probable of occurring within the hedge period, this paragraph does not apply, and an entity shall apply the guidance in paragraphs 815-30-40-4 through 815-30-40-6. Example 25 (see paragraph 815-30-55-158) illustrates the application of this guidance.

815-30-35-37E See implementation guidance related to the designation and documentation of a cash flow hedge and a change in the designated hedged risk beginning in paragraph 815-30-55-1G.

> > Change in Method of Identifying a Hedged Transaction with an Undocumented Hedged Risk after It Occurred

815-30-35-45A If an entity identifies an improved method of identifying a hedged transaction with an undocumented hedged risk after it occurred in accordance with the guidance in paragraph 815-20-25-22F 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.

7. Supersede paragraph 815-30-55-1A and its related heading, 815-30-55-98 through 55-98A, and 815-30-55-99, add paragraphs 815-30-55-1B through 55-1W and their related headings, 815-30-55-96A, 815-30-55-98B through 55-98C, and 815-30-55-149 through 55-170 and their related headings, and amend paragraphs 815-30-55-54, 815-30-55-60 through 55-61, and 815-30-55-97, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Illustrations

~~> > Example 1: Effectiveness of Cash Flow Hedge of a Forecasted Purchase of Inventory with a Forward Contract~~

815-30-55-1A Paragraph superseded by Accounting Standards Update No. 2020-XX.~~This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to assessing effectiveness 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 at inception.~~ **[Content moved to paragraph 815-30-55-1W]**

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

815-30-55-1B This guidance discusses the implementation of paragraphs ~~815-20-25-22B~~ 815-20-25-22D and 815-30-35-37A through 35-37B. 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. **[Content amended as shown and moved from paragraph 815-20-55-26B. See Issue 2 for proposed amendments.]**

815-30-55-1C 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 **{add glossary link}**cash flow hedge**{add glossary link}** 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~~ met. As part of that determination, Entity A prospectively assesses hedge effectiveness in accordance with paragraph 815-20-25-79B and determines that the requirements of ~~paragraph 815-20-25-22A~~ paragraphs 815-20-25-22C and 815-20-25-22E will be met in the contract once executed in accordance with paragraph 815-20-25-22D ~~815-20-25-22B~~. Entity A also will assess whether the criteria in ~~815-20-25-22A~~ paragraphs 815-20-25-22C and 815-20-25-22E are met when the contract is executed. **[Content amended as shown and moved from paragraph 815-20-55-26C. See Issue 2 for proposed amendments.]**

815-30-55-1D As part of its normal process of assessing whether it remains probable that the hedged forecasted transactions will occur and as part of its required quarterly reassessment of its best estimate of the hedged risk in accordance with paragraph 815-30-35-37B, 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 retrospectively assesses hedge effectiveness on the basis of the changes in cash flows associated with the forecasted purchases of soybeans attributable to variability in the ABC soybean index and begins prospectively 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 in accordance with paragraph 815-30-35-1B. When assessing hedge effectiveness with the revised hedged risk (that is, the XYZ soybean index), Entity A creates the terms of the instrument used to estimate changes in the value of the revised hedged risk (either under the hypothetical derivative method or another acceptable method in Subtopic 815-30) on the basis of market data as of the inception of the hedging relationship. 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.~~ **[Content amended as shown and moved from paragraph 815-20-55-26D. See Issue 2 for proposed amendments.]**

815-30-55-1E In subsequent periods after the initial prospective assessment of hedge effectiveness using variability in the XYZ soybean index, Entity A retrospectively assesses hedge effectiveness using variability in the XYZ soybean index for the periods it was the entity's then-best estimate (which would not include any periods before the change in hedged risk was identified). 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. **[Content amended as shown and moved from paragraph 815-20-55-26D. See Issue 2 for proposed amendments.]**

815-30-55-1F If on March 31, 20X1, the forward contract indexed to the ABC soybean index ~~the hedging instrument~~ is not highly effective at achieving offsetting cash flows attributable to the XYZ soybean index (the revised contractually specified ~~component,~~ component) on a prospective basis, the hedging relationship must be discontinued on March 31, 20X1. In that case, ~~As~~ as long as it is not probable that the hedged forecasted transactions (that is, the forecasted purchases of the specified quantity of soybeans) ~~are still probable of occurring~~ will not occur by June 30, 20X1, or within an additional two-month period of time thereafter in accordance with paragraph 815-30-40-4 and the retrospective hedge effectiveness assessment based on variability in the ABC soybean index indicated that the hedging relationship was highly effective from the period of January 1, 20X1, to March 31, 20X1, 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 in accordance with paragraph 815-20-45-1A. 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 by June 30, 20X1, or within an additional two-month period of time thereafter in accordance with paragraph 815-30-40-4. 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. **[Content amended as shown and moved from paragraph 815-20-55-26E. See Issue 2 for proposed amendments.]**

> > Hedge Designation and Documentation—Cash Flow Hedge

815-30-55-1G This guidance discusses the implementation of paragraphs 815-30-35-37A through 35-37D. This implementation guidance applies to both a cash flow hedge of a single forecasted transaction and to a cash flow hedge of aggregate individual forecasted transactions in accordance with paragraphs 815-20-55-20 through 55-23B.

815-30-55-1H Paragraphs 815-20-25-3 and 815-20-25-15 set forth hedge documentation and designation requirements for a cash flow hedge of a **forecasted transaction**. For purposes of applying the guidance in those paragraphs for the documentation and designation of a cash flow hedge of a forecasted transaction, an entity should consider the forecasted transaction and the hedged risk to be distinct from one another. The forecasted transaction should be considered in the context of the underlying transaction, that is, the external event involving the transfer of something of value (future economic benefit) between two (or more) entities. The hedged risk is the index or price that determines the amount, or a component of the amount, of the value transferred. Fluctuations in the hedged risk in periods before the future event occurs create the cash flow variability that is hedged in a cash flow hedge of a forecasted transaction.

815-30-55-1I In accordance with paragraph 815-20-25-3(b)(2), at inception of a cash flow hedge of a forecasted transaction, an entity should document the nature of both the forecasted transaction and the hedged risk. In documenting the forecasted transaction, an entity should consider the specificity requirements in paragraph 815-20-25-3(d)(1)(i) through (vi). In documenting the best estimate of its hedged risk for hedges that qualify for the change in hedged risk guidance in paragraphs 815-30-35-37A through 35-37C, an entity should consider the designation and documentation requirements in paragraphs 815-20-25-3(d)(1)(vii) through (viii), 815-20-25-15(i)(2) through (3), and 815-20-25-15(j)(1) through (2). The documentation must provide enough information about the forecasted transaction such that, when considered in combination with the hedged risk, it would enable an entity to identify the transaction as the hedged transaction when it occurs.

> > > The Forecasted Transaction

815-30-55-1J In a cash flow hedge in which the forecasted transaction is future interest receipts of a financial asset or future interest payments of a financial liability, documentation of the forecasted transaction should include:

a. The expected amount of principal on which future interest cash flows are expected to be received or paid
b. An entity’s best estimate of the timing of future interest receipts or payments or debt purchase or proceeds in accordance with paragraphs 815-20-25-16(d) and 815-20-25-3(d)(1)(i) and (vi)
c. Information about the nature of the related financial asset or liability in accordance with paragraph 815-20-25-3(d)(1)(ii).

815-30-55-1K In a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, documentation of the forecasted transaction should include:

a. The specific type of nonfinancial asset that is expected to be purchased or sold in accordance with paragraph 815-20-25-3(d)(1)(ii)
b. The physical quantity of the nonfinancial asset encompassed by the forecasted transaction in accordance with paragraph 815-20-25-3(d)(1)(iii)(02)

c. The best estimate of the timing of the forecasted transaction in accordance with paragraphs 815-20-25-16(d) and 815-20-25-3(d)(1)(i) and (vi).

For example, an entity should identify the forecasted transaction on the basis of a defined quantity of a specific raw agricultural commodity (such as soybeans, wheat, or coffee), a specific metal (such as copper, silver, or aluminum), a specific processed commodity (such as soybean oil or soybean meal), or a specific refined product (such as heating oil, jet fuel, or diesel fuel) to be purchased or sold on a specific date or during a specific time period. An entity should not document the forecasted transaction to purchase or sell a nonfinancial asset so broadly that many different transactions could be identified as the hedged forecasted transaction. For example, an entity should not document the forecasted transaction broadly as sales of grains or precious metals because that broad documentation could allow a wide variety of transactions to be identified as the hedged forecasted transaction and, therefore, does not satisfy the requirements in paragraph 815-20-25-3(d)(1)(ii).

> > > The Hedged Risk

815-30-55-1L The hedged risk documented at inception of the hedging relationship is not required to be the risk that ultimately causes the variability in cash flows. Rather, the hedged risk documented at hedge inception should represent an entity's best estimate of the hedged risk expected to cause the variability in cash flows in the forecasted transaction when it occurs in accordance with paragraph 815-20-25-3(d)(1)(vii) or (viii). See paragraphs 815-20-25-22C through 25-22E for additional guidance on designating as the hedged risk the variability in cash flows attributable to changes in a contractually specified component for the purchase or sale of a nonfinancial asset.

815-30-55-1M An entity is not required to document all possible hedged risks that may be present in the hedged forecasted transaction when it occurs. An entity may designate and document the hedged risk as follows:

a. For a cash flow hedge of interest rate risk related to a forecasted purchase or issuance of a debt instrument or an existing debt instrument in accordance with paragraph 815-20-25-15(j)(2), the single contractually specified interest rate that is its best estimate of the hedged risk expected to be present in the hedged forecasted transaction when it occurs. If an entity's best estimate of the hedged risk represents a specific tenor of an interest rate, the entity should designate and document the tenor of the contractually specified interest rate.
b. For a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset in accordance with paragraph 815-20-25-15(i)(3), the single contractually specified component that is its best estimate of the hedged

risk expected to be present in the hedged forecasted transaction when it occurs.

An entity's approach for designating and documenting the hedged risk affects the assessment of hedge effectiveness and the identification of the hedged forecasted transaction when it occurs in accordance with paragraphs 815-30-55-1R through 55-1V.

> > Change in the Designated Hedged Risk

815-30-55-1N The guidance in paragraphs 815-30-35-37A through 35-37D applies regardless of the manner in which the forecasted transaction and the hedged risk are documented at hedge inception. The forecasted transaction and hedged risk may be documented on an integrated basis (for example, the variability in the first 3-month LIBOR interest receipts on $100 million of outstanding loan principal in June 20X1 as both the forecasted transactions and the hedged risk) or separately (for example, the first interest receipts on $100 million of outstanding loan principal in June 20X1, the forecasted transactions, which fluctuate based on 3-month LIBOR, the hedged risk). Regardless of the manner in which the forecasted transaction and hedged risk are documented in a cash flow hedge of interest rate risk, the tenor of an interest rate index is considered an attribute of the hedged risk.

815-30-55-1O An entity may elect to remove the designation of a cash flow hedge in accordance with paragraph 815-30-40-1(c) at any time after hedge designation. However, an entity may not elect to apply the guidance in paragraph 815-30-40-5 if the hedged risk changes. For example, if an entity identifies that a change in hedged risk occurred in accordance with paragraph 815-30-35-37C, it may not immediately reclassify into earnings the derivative instrument gain or loss reported in accumulated other comprehensive income. Because a shortfall in forecasted transactions does not exist if an entity is applying the guidance in either paragraph 815-30-35-37A or 815-30-35-37C to identify a hedged transaction with a revised risk, the entity should not apply the guidance in paragraph 815-30-40-5 instead of the guidance in either paragraph 815-30-35-37A or paragraph 815-30-35-37C and immediately reclassify the derivative instrument gain or loss associated with the hedged transaction with the revised risk.

815-30-55-1P The guidance in either paragraph 815-30-35-37A or paragraph 815-30-35-37C on changing to an undocumented hedged risk also applies if the hedged risk changes from a designated contractually specified component or contractually specified interest rate risk to undocumented overall price risk or vice versa (that is, from designated overall price risk to an undocumented contractually specified component or contractually specified interest rate risk). That guidance also applies if the hedged risk changes from a designated variable rate to an undocumented fixed rate or vice versa in the instance of a hedge of a forecasted issuance or purchase of a fixed-rate debt instrument that changes to a variable-rate debt instrument.

815-30-55-1Q If, as part of its normal process of assessing whether it remains probable that the forecasted transaction will occur or as part of its required quarterly reassessment of its best estimate of the hedged risk in accordance with paragraph 815-30-35-37B, an entity identifies that a change in the hedged risk has occurred, it should provide an addendum to its initial hedge documentation noting that the best estimate of its expected hedged risk has changed and that it will perform all assessments of hedge effectiveness after the date that the change was identified based on the revised hedged risk in accordance with paragraph 815-30-35-1B. When applying the guidance in paragraphs 815-30-35-37A through 35-37B and an entity also identifies that the number or timing (or both) of the forecasted interest receipts or payments changed within the hedge period in accordance with paragraph 815-30-35-37D, it also should include in its addendum the revised number of transactions or revised timing of those transactions (or both).

> > > Assessment of Hedge Effectiveness

815-30-55-1R An entity's assessment of hedge effectiveness in a cash flow hedge is associated with its documentation of the hedging relationship required by paragraph 815-20-25-3(b)(2) and further discussed in paragraphs 815-30-55-1M and 815-30-55-1Q. At inception of a cash flow hedge of a forecasted transaction and on an ongoing basis, an entity should assess hedge effectiveness related only to the hedged risk documented as its best estimate of the hedged risk at the inception of the hedging relationship or subsequently documented in accordance with paragraph 815-30-55-1Q. An entity is not required to assess whether the derivative designated as the hedging instrument is highly effective at achieving offsetting cash flows attributable to any other potential hedged risks that are not the entity's best estimate. The following are examples of how an entity's hedge designation and documentation relate to the assessment of hedge effectiveness:

a. In a cash flow hedge of variable interest receipts or payments, if the entity designates and documents as the hedged risk the contractually specified interest rate that is its best estimate of the hedged risk expected to be present in the hedged forecasted transactions when they occur, it should assess hedge effectiveness related only to that hedged risk in accordance with paragraphs 815-20-25-79B and 815-30-35-1B.
b. In a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset, if the entity designates and documents as the hedged risk the contractually specified component that is its best estimate of the hedged risk expected to be present in the hedged forecasted transaction when it occurs, it should assess hedge effectiveness related only to that hedged risk in accordance with paragraphs 815-20-25-79B and 815-30-35-1B.

After the designated hedged risk has changed, the entity should assess hedge effectiveness in accordance with paragraph 815-20-25-79B.

> > > Identifying the Hedged Forecasted Transaction When It Occurs

815-30-55-1S An entity's identification of transactions as hedged forecasted transactions when they occur for purposes of reclassifying amounts in accumulated other comprehensive income to earnings is associated with its documentation of the hedging relationship required by paragraph 815-20-25-3(b)(2) and further discussed in paragraphs 815-30-55-1M and 815-30-55-1Q. An entity should use the combination of the documented forecasted transaction and hedged risk (which was either documented at hedge inception or subsequently in an addendum in accordance with paragraph 815-30-55-1Q) in first identifying transactions as the hedged forecasted transactions when they occur during the hedge period. For example, if an entity hedges aggregate individual forecasted transactions in accordance with paragraphs 815-20-55-20 through 55-22 and designates and documents as the hedged risk a contractually specified interest rate or a contractually specified component that is its best estimate of the hedged risk expected to be present in the forecasted transactions when they occur, it should first identify those transactions that relate to that hedged risk as the hedged forecasted transactions.

815-30-55-1T In applying the guidance in paragraph 815-30-35-37C, an entity should identify transactions that occurred in the hedge period with an undocumented hedged risk as hedged transactions in accordance with the entity's method of identifying hedged transactions described in paragraph 815-20-25-3(d)(1)(ix) before identifying transactions that occurred in the two-month period thereafter (in accordance with paragraph 815-30-40-4). If there are insufficient transactions that occurred in the hedge period, then the entity should identify eligible hedged transactions that occurred in the two-month period thereafter. When applying the guidance in paragraph 815-30-35-37C to transactions that occurred during the two-month period thereafter, an entity should first identify hedged transactions that occurred with the documented hedged risk before identifying hedged transactions in accordance with the entity's method described in paragraph 815-20-25-3(d)(1)(ix). Example 24, Cases B and C (see paragraphs 815-30-55-153 through 55-157) illustrate the application of this guidance. The method used should meet the requirements of paragraph 815-20-25-22F and could be based on any of a variety of attributes of the forecasted transaction such as, but not limited to, timing, risk, location, or supplier. The transactions with undocumented hedged risks identified as hedged transactions should be the same as the forecasted transactions documented at hedge inception. They should be those transactions that fulfill the shortfall in transactions that occurred with the documented hedged risk within the originally specified time period plus an additional two-month period, if applicable, in accordance with paragraph 815-30-

40-4. Example 26 (see paragraph 815-30-55-161) illustrates the application of this guidance.

815-30-55-1U For purposes of reclassifying amounts from accumulated other comprehensive income to earnings, an entity should identify transactions as hedged forecasted transactions that occurred during the designated forecasted period plus an additional two-month period thereafter, if applicable, in accordance with paragraph 815-30-40-4. If an entity determines that the forecasted transactions remain probable of occurring in accordance with paragraph 815-30-35-37A but that it expects a shortfall in transactions occurring with the documented hedged risk, amounts recorded in accumulated other comprehensive income should be reclassified to earnings when the forecasted transactions associated with the revised hedged risk affect earnings. Similarly, if an entity determines that the forecasted transactions occurred in accordance with paragraph 815-30-35-37C but there was a shortfall in transactions occurring with the documented hedged risk, amounts recorded in accumulated other comprehensive income should be reclassified to earnings when the hedged transactions identified in accordance with paragraph 815-30-55-1T affect earnings.

815-30-55-1V In applying the guidance in paragraphs 815-30-35-37C and 815-30-55-1T, an entity may identify a hedged transaction in a period after it affected reported earnings. In that circumstance, amounts recorded in accumulated other comprehensive income related to a hedged transaction that affected prior reported earnings should immediately be reclassified to earnings in the current period upon identification as a hedged transaction in accordance with paragraph 815-30-55-1T. Even though the reclassification occurs in a period after the hedged item affected earnings, those amounts 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.

> Illustrations

> > Example 1: Effectiveness of Cash Flow Hedge of a Forecasted Purchase of Inventory with a Forward Contract

815-30-55-1W This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to assessing effectiveness 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 at inception. **[Content moved from paragraph 815-30-55-1A]**

> > 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:

a. The variability of the hedged interest payments is eliminated before the hedging derivative expires (Case A).
b. 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. Entity MNO's best estimate is that the ~~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 interest rate (that is, the LIBOR rate) designated under paragraph 815-20-25-15(j)(2), Entity MNO may conclude that 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 is part of a pattern of hedged forecasted transactions 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 <u>hedged risk best estimate of a</u> different contractually specified interest rate (that is, an interest rate that is not LIBOR) that adjusts every 90 days. 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 <u>in accordance with paragraph 815-30-35-1B. When assessing hedge effectiveness with the revised contractually specified interest rate, Entity MNO creates the terms of the instrument used to estimate changes in the value of the revised hedged risk (under either the hypothetical derivative method or another acceptable method in Subtopic 815-30) on the basis of market data as of the inception of the hedging relationship</u>. 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.

815-30-55-61 If the revised hedging relationship is not determined to be highly effective <u>in accordance with paragraph 815-30-35-1B</u>, the hedging relationship must be discontinued <u>in accordance with paragraph 815-30-35-37A</u>. However, 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 probable that the hedged transactions (future interest payments) will not occur. In this case, the expected amounts of those payments have changed (because they will be based on 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.

> > 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 **benchmark interest rate** 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.

815-30-55-96A 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, 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, it 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). **[Content amended as shown and moved from paragraph 815-30-55-98]**

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,~~ For the forecasted transactions determined to be probable, Entity A must then ~~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 considers the revised hedged risk (that is, the five-year benchmark borrowing rate for payments in Years 1–5 and Entity A's best estimate of the rate associated with the payments to be made in Years 6–10) in accordance with paragraph 815-30-35-1B. That is, the assessment of hedge effectiveness should be based on the most recent best estimate of the hedged forecasted transaction that considers the revised hedged risk as of the date that the change in hedged risk is identified ~~a cash flow hedge is discontinued prospectively~~.

815-30-55-98 Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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).~~ **[Content amended and moved to paragraph 815-30-55-96A]**

815-30-55-98A Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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. 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 815-30-55-98C]**

815-30-55-98B 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 nonoccuring 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. **[Content moved from paragraph 815-30-55-99]**

815-30-55-98C When the change in hedged risk is identified in the week before issuance, Entity A performs its ~~semimonthly~~ retrospective assessment of effectiveness for the ~~half-month~~ period ~~immediately preceding the issuance of the debt, it~~ from the date of its last assessment to the date that the change in hedged risk was identified using the 10-year borrowing rate in accordance with paragraph 815-30-35-1B. To determine whether hedge accounting can continue prospectively, Entity A performs its prospective assessment of effectiveness for the period beginning on the date that the change in hedged risk is identified using its revised hedged risk best estimate of the five-year borrowing rate for forecasted interest payments expected in Years 1–5 and its best estimate of the hedged risk expected to present in the forecasted interest payments in Years 6–10 in accordance with paragraphs 815-20-25-79B and 815-30-35-1B. After Year 5, Entity A expects to borrow in the form of a five-year variable-rate loan based on a contractually specified interest rate. When assessing hedge effectiveness with the revised hedged risk (that is, the five-year borrowing rate for forecasted payments expected in the first five years and the contractually specified interest rate for forecasted payments expected in the latter five years), Entity A creates the terms of the instrument used to estimate changes in value of the hedged risk (under either the hypothetical derivative method or another acceptable method in Subtopic 815-30) on the basis of market data as of the inception of the hedging relationship. As a result, Entity A 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 and variability in the hedged interest payments for Years 6–10 is now based on Entity A's best estimate of the contractually specified interest rate expected to be present in the loan—not on 10-year rates as expected at the inception of the hedge when ~~the entity~~ Entity A selected the hedging derivative. In that circumstance, the hedging relationship is terminated if the hedging derivative is not highly effective against the revised hedged risks. 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 815-30-55-98A]**

815-30-55-99 Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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 nonoccuring 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.~~ **[Content amended and moved to paragraph 815-30-55-98B]**

> > Example 24: Application of Change in Hedged Risk to Transactions That Occur in the Originally Specified Period and the Two-Month Period Thereafter

815-30-55-149 The following Cases illustrate the application of paragraphs 815-30-35-37A through 35-37C in the following circumstances:

a. An expected shortfall in forecasted transactions with the designated hedged risk is identified before the forecasted transactions occur, and transactions expected to occur in the additional two-month period are not identified as hedged (that is, all forecasted transactions are expected to occur during the hedge period) (Case A).
b. An experienced shortfall in forecasted transactions with the designated hedged risk is identified after the forecasted transactions occur, and transactions expected to occur in the additional two-month period are not identified as hedged (that is, all forecasted transactions occur during the hedge period) (Case B).
c. An experienced shortfall in forecasted transactions with the designated hedged risk is identified after the forecasted transactions occur, and forecasted transactions occurring in the additional two-month period are identified as hedged (that is, not all forecasted transactions occur during the hedge period) (Case C).

815-30-55-150 Cases A, B, and C share the following assumptions:

a. At hedge inception, Entity A expects to purchase 1,000 bushels of soybeans during June 20X1 and another 1,000 bushels during July 20X1.
b. At hedge inception, Entity A expects cash flows associated with those purchases to vary with the ABC soybean index.
c. To hedge the risk of changes in forecasted soybean purchases expected during June 20X1 attributable to the changes in the ABC soybean index, Entity A does the following:

1. Enters into a derivative instrument (for example, an ABC soybean index futures contract) on January 1, 20X1
2. Documents that it is hedging the variability in the forecasted purchase of the first 1,000 bushels of soybeans in June 20X1 attributable to its best estimate of the hedged risk expected to be present in those purchases, the ABC soybean index
3. Documents its method that will be used to identify a hedged transaction with an undocumented hedged risk after it occurred if applying the guidance in paragraph 815-30-35-37C in accordance with paragraph 815-20-25-3(d)(1)(ix).

> > > Case A: An Expected Shortfall in Forecasted Transactions with the Designated Hedged Risk Is Identified before the Forecasted Transactions Occur, and Transactions in the Additional Two-Month Period Are Not Identified as Hedged

815-30-55-151 This case has the following assumptions:

a. Entity A identifies on March 31, 20X1, that its hedged risk best estimate has changed for its forecasted purchase of 1,000 bushels of soybeans in June 20X1 from the ABC soybean index to the XYZ soybean index.
b. On March 31, 20X1, Entity A continues to expect to purchase 1,000 bushels of soybeans in July 20X1 at the ABC soybean index.

815-30-55-152 In accordance with paragraphs 815-30-35-37A through 35-37B, Entity A applies the change in hedged risk guidance as follows:

a. On March 31, 20X1, in accordance with paragraph 815-30-35-1Q, Entity A adds an addendum to its initial hedge documentation noting that the best estimate of its expected hedged risk has changed to the XYZ soybean index and that all assessments of hedge effectiveness will be performed for periods beginning after March 31, 20X1, based on the XYZ soybean index in accordance with paragraph 815-30-35-1B.
b. Entity A may continue to apply hedge accounting if the hedging instrument is prospectively expected to be highly effective at achieving offsetting cash flows attributable to the forecasted transactions with the revised hedged risk (that is, the XYZ soybean index) in accordance with paragraph 815-30-35-1B and all other criteria to apply cash flow hedge accounting continue to be met.
c. Entity A should discontinue hedge accounting if the hedging instrument is prospectively expected to not be highly effective at achieving offsetting cash flows attributable to the forecasted transactions with the revised hedge risk (that is, the XYZ soybean index) in accordance with paragraph 815-30-35-1B.
d. Entity A should not identify forecasted soybean purchases to occur in July 20X1 with the risk of the ABC soybean index as hedged transactions

because there is no expected shortfall in forecasted purchases of soybeans expected to occur in June 20X1 after considering all risks.

> > > Case B: An Experienced Shortfall in Forecasted Transactions with the Designated Hedged Risk Is Identified after the Forecasted Transactions Occur, and Transactions in the Additional Two-Month Period Are Not Identified as Hedged

815-30-55-153 An experienced shortfall in forecasted transactions with the designated hedged risk is identified after the forecasted transactions occur, and transactions expected to occur in the additional two-month period are not identified as hedged (that is, all forecasted transactions occur during the hedge period) (Case B).

815-30-55-154 This Case has the following assumptions:

a. Entity A identifies on June 30, 20X1, after purchasing all 1,000 bushels of soybeans during the month (the forecasted transactions), that there was a shortfall in transactions that occurred in June 20X1 with its designated hedged risk of the ABC soybean index.
b. The shortfall in bushels purchased with the ABC soybean index in June 20X1 was fulfilled by bushels purchased with other soybean indexes.
c. On June 30, 20X1, Entity A continues to expect to purchase 1,000 bushels of soybeans in July 20X1 at the ABC soybean index.

815-30-55-155 In accordance with paragraph 815-30-35-37C, Entity A applies the change in hedged risk guidance as follows:

a. On June 30, 20X1, Entity A identifies hedged transactions with an undocumented risk among the 1,000 bushels of soybeans purchased in June 20X1 in accordance with its method of identifying hedged transactions described in paragraph 815-20-25-3(d)(1)(ix).
b. Entity A does not identify any of the 1,000 bushels of soybeans expected to be purchased at the ABC soybean index in July 20X1 as the hedged transactions because there was no shortfall in soybean purchases that occurred in June 20X1 after considering all risks. Accordingly, Entity A should not apply the guidance in paragraph 815-30-40-4 that indicates that it should identify hedged transactions that occur in the two-month period following the originally specified time period when there is a shortfall in hedged transactions that occurred in the originally specified time period after considering all risks.

> > > Case C: An Experienced Shortfall in Forecasted Transactions with the Designated Hedged Risk Is Identified after the Forecasted Transactions Occur, and Transactions in the Additional Two-Month Period Are Identified as Hedged

815-30-55-156 This case has the following assumptions:

a. Entity A identifies on June 30, 20X1, that only 900 of the forecasted 1,000 bushels of soybeans were purchased during the month.
b. Of the 900 bushels purchases in June 20X1, there was a shortfall in transactions that occurred with Entity A's designated hedged risk of the ABC soybean index.
c. The shortfall in bushels purchased in June 20X1 was fulfilled by bushels purchased in July 20X1.

815-30-55-157 In accordance with paragraph 815-30-35-37C, Entity A applies the change in hedged risk guidance as follows:

a. On June 30, 20X1, Entity A first identifies transactions in the 900 bushels purchased in June 20X1 with the documented hedged risk (that is, the ABC soybean index) as hedged transactions. Entity A then identifies the remainder of bushels in the 900 bushels purchased as hedged transactions with an undocumented risk in accordance with its method of identifying hedged transactions described in paragraph 815-20-25-3(d)(1)(ix).
b. Entity A could identify that the 100 bushel shortfall was fulfilled in July 20X1 in accordance with paragraph 815-30-40-4. In that circumstance, Entity A would first identify transactions in the 100 bushels purchased in July 20X1 with its documented hedged risk (that is, the ABC soybean index) as hedged transactions. Entity A would then identify the remainder of bushels in the 100 bushels purchased as hedged transactions with an undocumented risk in accordance with its method of identifying hedged transactions described in paragraph 815-20-25-3(d)(1)(ix).

> > Example 25: Change in Hedged Risk in a Hedge of Interest Rate Risk That Results in a Change in Number and Timing of Interest Payments

815-30-55-158 This Example illustrates the application of paragraphs 815-30-35-37D, 815-30-55-1N, and 815-30-55-1Q. Entity A begins a $100 million 10-year variable-rate borrowing program on January 1, 20X1. Entity A enters into a hedging relationship on January 1, 20X1, to hedge the variability in future interest payments attributable to interest rate risk associated with that borrowing program over the next 10 years. At hedge inception, Entity A designates a contractually specified interest rate with a 1-month tenor as its best estimate of the hedged risk associated with that $100 million borrowing program. Accordingly, the forecasted transaction is designated as a series of 120 interest payments with the payments occurring monthly over the 10-year period beginning on January 1, 20X1.

815-30-55-159 On January 1, 20X6, 5 years after hedge inception, Entity A extinguishes its existing debt on which it made 60 monthly payments at the initially designated contractually specified interest rate with a 1-month tenor. In its place, Entity A secures new five-year borrowings at a contractually specified interest rate with a three-month tenor. Consequentially, the remaining interest payments change to total 20 quarterly payments rather than 60 monthly payments.

> > > Analysis

815-30-55-160 On January 1, 20X6, Entity A should add an addendum to its initial hedge documentation noting that the best estimate of its expected hedged risk has changed and, as a result, the number and timing of forecasted payments also have changed. Entity A may continue to apply hedge accounting in accordance with paragraph 815-30-35-37A if the hedging instrument is expected to be a highly effective hedge of the forecasted interest payments with the revised hedged risk (that is, the contractually specified interest rate with the 3-month tenor), revised number of settlements (that is, 20 remaining), and revised settlement timing (that is, quarterly) in accordance with paragraph 815-30-35-1B and all other criteria to apply cash flow hedge accounting continue to be met. If, as a result of the change in the hedged risk, a forecasted interest payment no longer is probable to occur within the 10-year period initially designated, Entity A would be required to discontinue hedge accounting for the portion of the hedging instrument associated with the nonprobable interest payments. Entity A would then apply the guidance in paragraphs 815-30-40-4 through 40-5 to determine whether the amount associated with the discontinued portion of the hedging instrument recorded in accumulated other comprehensive income should be immediately recognized in earnings.

> > Example 26: Effect on Accumulated Other Comprehensive Income from Changes in a Cash Flow Hedge

815-30-55-161 The following Cases illustrate the application of paragraphs 815-20-25-22F, 815-20-25-79B, 815-30-35-1B, 815-30-35-37C, 815-30-55-1G through 55-1V, and 815-30-40-5 in determining the effects on earnings and other comprehensive income when certain changes in a cash flow hedging relationship occur:

a. An experienced shortfall in forecasted transactions with the designated hedged risk occurs in the originally specified period (Case A).
b. An experienced shortfall in forecasted transactions occurs in the originally specified period, but the shortfall is fulfilled in the two-month period thereafter (Case B).
c. An experienced shortfall in forecasted transactions occurs (Case C).

815-30-55-162 Cases A, B, and C share the following assumptions:

a. Entity A expects to purchase 1,000 metric tons of cocoa beans in Location 1 during March 20X1.
b. Entity A's best estimate of the risk expected to be present in those purchases is the ABC cocoa bean index.

c. To hedge the risk of changes in those forecasted cocoa bean purchases attributable to the changes in the ABC cocoa bean index, Entity A does the following:
    1. Enters into a derivative instrument (for example, an ABC cocoa bean index futures contract) on January 1, 20X1
    2. Documents that it is hedging the variability in the forecasted purchase of the first 1,000 metric tons of cocoa beans in Location 1 in March 20X1 attributable to its best estimate of the hedged risk expected to be present in those purchases, the ABC cocoa bean index
    3. Documents the method that it will use to identify a hedged transaction with an undocumented hedged risk after it occurred if applying the guidance in paragraph 815-30-35-37C in accordance with paragraph 815-20-25-3(d)(1)(ix). Entity A's method is to identify transactions that occurred with an undocumented hedged risk that have not yet affected reported earnings as hedged transactions before transactions that occurred with an undocumented hedged risk that have affected reported earnings.

d. Throughout the hedging relationship Entity A prospectively assesses hedge effectiveness only considering changes in its best estimate of the hedged risk expected to be present in the forecasted purchases when they occur (that is, the ABC cocoa bean index) in accordance with paragraph 815-20-25-79B.

e. On March 31, 20X1, the hedging relationship is assessed as highly effective on the basis of Entity A's best estimate of the hedged risk throughout March 20X1 (that is, the ABC cocoa bean index).

f. Entity A has a reporting date of March 31, 20X1.

> > > Case A: An Experienced Shortfall in Forecasted Transactions with the Designated Hedged Risk Occurs in the Originally Specified Period

815-30-55-163 This Case has the following assumptions:

a. Entity A purchased 600 metric tons of cocoa beans indexed to the ABC cocoa bean index during March 20X1, all of which affected earnings in April 20X1.

b. Entity A purchased 500 metric tons of cocoa beans indexed to the DEF cocoa bean index during March 20X1. Of those purchases, 400 metric tons affected earnings in the reporting period ended March 31, 20X1, while the remaining 100 metric tons affected earnings in April 20X1.

c. Entity A purchased 700 metric tons of cocoa beans indexed to the ABC cocoa bean index during April 20X1.

d. All purchases occurred at Location 1.

815-30-55-164 In accordance with paragraphs 815-30-35-37C and 815-30-55-1S through 55-1T, Entity A identifies hedged forecasted transactions as follows:

a. First, cocoa bean purchases that occurred during the originally specified period indexed to the documented hedged risk (that is, the 600 metric tons of cocoa bean purchases indexed to the ABC cocoa bean index that occurred during March 20X1)
b. Second, cocoa bean purchases that occurred during the originally specified period with an undocumented hedged risk that have not yet affected reported earnings in accordance with Entity's A method for identifying hedged transactions when applying the guidance in paragraph 815-30-35-37C (that is, the 100 metric tons of cocoa bean purchases indexed to the DEF cocoa bean index that occurred during March 20X1 that affected earnings in April 20X1)
c. Third, cocoa bean purchases that occurred during the originally specified period with an undocumented hedged risk that affected reported earnings in the period ended March 31, 20X1, in accordance with Entity A's method for identifying hedged transactions when applying the guidance in paragraph 815-30-35-37C but only the amount needed to fulfill the shortfall in the amount of forecasted purchases designated as hedged (that is, the 300 of the 400 metric tons of cocoa bean purchases indexed to the DEF cocoa bean index that occurred during March 20X1 that affected earnings in the reporting period ended March 31, 20X1).

Entity A does not identify any of the 700 metric tons of cocoa beans indexed to the ABC cocoa bean index that were purchased during April 20X1 as hedged transactions because sufficient forecasted transactions occurred during the originally specified period to fulfill the amount of forecasted transactions hedged at inception. Entity A would have identified cocoa bean purchases that occurred during April 20X1 as hedged transactions only if there was a shortfall in cocoa bean purchases that occurred during the hedge period (that is, March 20X1) considering all risks.

815-30-55-165 As of the March 31, 20X1 reporting date, Entity A reclassifies amounts from accumulated other comprehensive income to earnings associated with the 300 DEF-indexed cocoa beans identified as hedged in paragraph 815-30-55-164(c) in March 20X1 and amounts associated with the 600 ABC-indexed and 100 DEF-indexed cocoa beans identified as hedged in paragraph 815-30-55-164(a) and (b), respectively, in April 20X1. The guidance in paragraph 815-30-40-5 does not apply in this Case because Entity A fulfilled the designated amount of forecasted transactions (that is 1,000 metric tons of cocoa beans) in the originally specified period or within the additional 2-month period of time thereafter.

> > > Case B: An Experienced Shortfall in Forecasted Transactions Occurs in the Originally Specified Period but Shortfall Fulfilled in the Two-Month Period Thereafter

815-30-55-166 This case has the following assumptions:

a. Entity A purchased 500 metric tons of cocoa beans indexed to the ABC cocoa bean index during March 20X1, all of which affected earnings in April 20X1.
b. Entity A purchased 300 metric tons of cocoa beans indexed to the DEF cocoa bean index during March 20X1. Of those purchases, 200 metric tons affected earnings in the reporting period ended March 31, 20X1, while the remaining 100 metric tons affected earnings in April 20X1.
c. Entity A purchased 50 metric tons of cocoa beans indexed to the ABC cocoa bean index during April 20X1, all of which affected earnings in May 20X1.
d. Entity A purchased 250 metric tons of cocoa beans indexed to the DEF cocoa bean index during April 20X1, all of which affected earnings in May 20X1.
e. All purchases occurred at Location 1.

815-30-55-167 In accordance with paragraphs 815-30-35-37C and 815-30-55-1S through 55-1T, Entity A identifies hedged forecasted transactions as follows:

a. First, cocoa bean purchases that occurred during the originally specified period indexed to the documented hedged risk (that is, the 500 metric tons of cocoa bean purchases indexed to the ABC cocoa bean index that occurred during March 20X1)
b. Second, cocoa bean purchases that occurred during the originally specified period with an undocumented hedged risk that have not yet affected reported earnings in accordance with Entity A's method for identifying hedged transactions when applying the guidance in paragraph 815-30-35-37C (that is, the 100 metric tons of cocoa bean purchases indexed to the DEF cocoa bean index that occurred during March 20X1 that affected earnings in April 20X1)
c. Third, cocoa bean purchases that occurred during the originally specified period with an undocumented hedged risk that affected reported earnings in the period ended March 31, 20X1, in accordance with Entity A's method for identifying hedged transactions when applying the guidance in paragraph 815-30-35-37C (that is, the 200 metric tons of cocoa bean purchases indexed to the DEF cocoa bean index that occurred during March 20X1 that affected earnings in the reporting period ended March 31, 20X1)
d. Fourth, cocoa bean purchases that occurred during the 2-month period of time after the originally specified period indexed to the documented hedged risk (that is, the 50 metric tons of cocoa bean purchases indexed to the ABC cocoa bean index that occurred during April 20X1)
e. Fifth, cocoa bean purchases that occurred during the 2-month period of time after the originally specified period with an undocumented hedged risk that have not yet affected reported earnings in accordance with Entity A's method for identifying hedged transactions when applying the

guidance in paragraph 815-30-35-37C but only the amount needed to the fulfill the shortfall in the amount of forecasted purchases designated as hedged (that is, 150 of the 250 metric tons of cocoa bean purchases indexed to the DEF cocoa bean index that occurred during April 20X1).

As illustrated in (a) through (e), Entity A identifies hedged transactions that occurred in the two-month period of time after the original specified period only after all forecasted transactions that occurred during the hedged period, regardless of risk, are identified as hedged.

815-30-55-168 Entity A reclassifies amounts from accumulated other comprehensive income to earnings associated with the 200 DEF-indexed cocoa beans identified as hedged in paragraph 815-30-55-167(c) in March 20X1 and amounts associated with the 500 ABC-indexed and 100 DEF-indexed cocoa beans identified as hedged in paragraph 815-30-55-167(a) and (b), respectively, in April 20X1. Lastly, Entity A reclassifies amounts from accumulated other comprehensive income to earnings associated with the 50 ABC-indexed and 150 DEF-indexed cocoa beans identified as hedged in paragraph 815-30-55-167(d) and (e), respectively, in May 20X1. The guidance in paragraph 815-30-40-5 does not apply in this Case because Entity A fulfilled the designated amount of forecasted transactions (that is 1,000 metric tons of cocoa beans) in the originally specified period plus the additional 2-month period of time thereafter.

> > > Case C: An Experienced Shortfall in Forecasted Transactions Occurs

815-30-55-169 This case has the following assumptions:

a. Entity A purchased 1,200 metric tons of cocoa beans indexed to the ABC cocoa bean index during March 20X1 at Location 2.
b. Entity A did not purchase any cocoa beans at Location 1 in the originally specified period or the two-month period of time thereafter.

815-30-55-170 Because Entity A decided to use location to identify forecasted transactions eligible to be designated as hedged when they occurred and did not purchase any cocoa beans at Location 1 in the originally specified period or the two-month period of time thereafter, the forecasted transaction described at hedge inception did not occur. Accordingly, Entity A immediately reclassifies into earnings the entire net gain or loss related to the derivative instrument in accumulated other comprehensive income, and the nonoccurrence of the forecasted transactions described in this Case could potentially jeopardize Entity A's ability to use cash flow hedge accounting in the future for similar forecasted transactions in accordance with paragraph 815-30-40-5. In this Case, Entity A chose to use location as an attribute of the forecasted transaction to determine eligibility for hedge accounting; however, in accordance with paragraph 815-20-25-3, an entity is not required to define eligible forecasted transactions using location.

Issue 2: Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions

8. The proposed amendments would:

   a. Clarify the nature of the documentation that may evidence a contractually specified component.
   b. Clarify that an entity may designate a contractually specified component as the hedged risk in a cash flow hedge of a forecasted transaction regardless of whether the documentation explicitly referencing the component is obtained before or after the forecasted transaction occurs. The proposed amendments would clarify that an entity may base its expectation that a contractually specified component will be explicitly referenced on prior experience with similar transactions.
   c. Clarify that to hedge a contractually specified component in an agreement to purchase or sell a nonfinancial asset that is eligible to be designated as a hedged forecasted transaction, an entity would need to apply only the portion of the normal purchases and normal sales scope exception that requires all pricing components in the agreement to be based on underlyings that are clearly and closely related to the asset being sold or purchased.
   d. Clarify that the pricing formula that includes the contractually specified component must determine the price of the nonfinancial asset but would prescribe no specific method to satisfy that requirement.
   e. Clarify that a purchase or sale of a nonfinancial asset accounted for as a derivative may be designated as the forecasted transaction in a cash flow hedge of either the variability of the overall price changes or the variability in a contractually specified component if physical settlement of the contract is probable and the forecasted transaction is not the acquisition of a nonfinancial asset that subsequently will be remeasured with changes in fair value attributable to the hedged risk reported in earnings.

Amendments to Subtopic 815-20

9. Amend paragraphs 815-20-25-15 and 815-20-25-84, add paragraphs 815-20-25-15B and 815-20-25-22C through 25-22E, and supersede paragraphs 815-20-25-22A through 25-22B, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Eligibility of Hedged Items and Transactions

> > Hedged Transaction Criteria Applicable to Cash Flow Hedges Only

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 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.
3. The risk of variability in cash flows attributable to changes in a **contractually specified component**. (See additional criteria in paragraphs 815-20-25-22C through 25-22E ~~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. 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 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.

815-20-25-15B If the forecasted transaction is the purchase or sale of a nonfinancial asset under a contract that is accounted for as a derivative under Topic 815, the criteria in paragraph 815-20-25-15(d) through (e) are met if both of the following criteria are met:

a. The occurrence of physical settlement of the contract is probable in accordance with paragraph 815-20-25-15(b).
b. The forecasted transaction is not the acquisition of a nonfinancial asset that subsequently will be remeasured with changes in fair value attributable to the hedged risk reported currently in earnings.

If any of the criteria are no longer met, an entity shall prospectively discontinue hedge accounting and apply paragraphs 815-30-40-4 through 40-6.

> > > 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 Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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 Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~

815-20-25-22C A **contractually specified component** is 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. A contractually specified component is evidenced by documentation that supports the price at which a nonfinancial asset is purchased or sold, regardless of whether the documentation is obtained before or after the transaction is consummated. Examples include a supply arrangement, an ancillary or side agreement, a governing agreement of a transaction, a purchase or sale contract that may be accounted for as a derivative under Topic 815 and meets the criteria in paragraph 815-20-25-15B, a spot transaction receipt, or other documentation that supports the price at which a nonfinancial asset is purchased or sold.

815-20-25-22D An entity may designate the variability in cash flows attributable to changes in a contractually specified component that is not yet explicitly referenced (for example, if the entity designates the cash flow hedge of the variability in a contractually specified component for a period longer than the contractual term or for a not-yet-existing contract to purchase or sell a nonfinancial asset) if it expects that the criteria in paragraph 815-20-25-22E will be met when the contractually specified component is explicitly referenced in an agreement. For example, an entity may base that expectation on prior experience with similar transactions. Once the contractually specified component is explicitly referenced in an agreement, the entity shall apply the guidance in paragraph 815-20-25-22E without dedesignating the hedging relationship.

815-20-25-22E An entity may designate the variability in cash flows attributable to changes in a contractually specified component that is explicitly referenced in an agreement as the hedged risk in a cash flow hedge if all the following criteria are met:

a. The forecasted purchase or sale meets all applicable criteria in paragraph 815-20-25-15 and paragraph 815-20-25-15B to be eligible for designation as the hedged transaction in a cash flow hedge.
b. All underlyings in the agreement are clearly and closely related to the asset being sold or purchased in accordance with the guidance in paragraphs 815-10-15-30 through 15-34. If an entity applies the normal purchases and normal sales scope exception guidance in accordance with Subtopic 815-10 to be eligible for cash flow hedge accounting in

accordance with (a) and paragraphs 815-20-25-7 through 25-9, this criterion already is met.

c. For non-spot-market transactions, the pricing formula that includes the contractually specified component determines the price of the nonfinancial asset.

d. For spot-market transactions, the pricing formula that includes the contractually specified component is based on how the price is determined in that nonfinancial asset's spot market.

See paragraphs 815-30-55-1B through 55-1E for related implementation guidance.

> Hedge Effectiveness

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

815-20-25-84 If the critical terms of the hedging instrument and of the hedged item 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 perfectly effective 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 815-20-25-22C through 25-22E ~~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 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.

10. Amend paragraphs 815-20-55-19 and 815-20-55-79P and supersede paragraphs 815-20-55-26A through 55-26E and their related headings, with a link to transition paragraph 815-20-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Eligibility of Hedged Items

> > > Hedged Items in Cash Flow Hedges Only

> > > > 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 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. 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. In accordance with paragraph 815-20-25-15(i), the 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. 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 paragraphs 815-20-25-22C through 25-22E ~~paragraph 815-20-25-22A~~ are met. In both scenarios, the entity 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.

~~**> > > > Determining Whether a Contractually Specified Component Exists**~~

815-20-55-26A Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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 Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~ **[Content amended and moved to paragraph 815-30-55-1B. See Issue 1 for proposed amendments.]**

815-20-55-26C Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~ **[Content amended and moved to paragraph 815-30-55-1C. See Issue 1 for proposed amendments.]**

815-20-55-26D Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~ **[Content amended and moved to paragraphs 815-30-55-1D through 55-1E. See Issue 1 for proposed amendments.]**

815-20-55-26E Paragraph superseded by Accounting Standards Update No. 2020-XX.~~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.~~ **[Content amended and moved to paragraph 815-30-55-1F. See Issue 1 for proposed amendments.]**

> > Hedge Effectiveness

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

> > > > 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~~ paragraphs 815-20-25-22C and 815-20-25-22E will be met in the contract once executed in accordance with paragraph 815-20-25-22D ~~815-20-25-22B~~. Entity B also will assess whether the criteria in ~~815-20-25-22A~~

paragraphs 815-20-25-22C and 815-20-25-22E are met in the contract when it is executed.

Amendments to Subtopic 815-30

11. Amend paragraphs 815-30-55-138 and 815-30-55-146, with a link to transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Cash Flow Hedges

Implementation Guidance and Illustrations

> Illustrations

> > Example 22: Assessing Effectiveness of a Cash Flow Hedge of a Forecasted Purchase of Inventory with a Forward Contract (Contractually Specified Component)

815-30-55-138 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~~ paragraphs 815-20-25-22C and 815-20-25-22E are met.

> > Example 23: Designation of a Cash Flow Hedge of a Forecasted Purchase of Inventory for Which Commodity Exposure Is Managed Centrally

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~~ paragraphs 815-20-25-22C and 815-20-25-22E are met.

Issue 3: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

12. The amendments in this proposed Update would eliminate the recognition and presentation mismatch related to a foreign-currency-denominated debt instrument designated as a hedging instrument in a hedge of a net investment in a foreign entity and a hedged item in a fair value hedge of interest rate risk (a dual hedge) caused by the amendments in Update 2017-12. The proposed amendments would eliminate that mismatch by requiring that an entity exclude the foreign-currency-denominated debt instrument's fair value hedge basis adjustment from the net investment hedge effectiveness assessment. As a result, the gains and losses on the remeasurement of the debt instrument's fair value hedge basis adjustment at the spot exchange rate would immediately be recognized in earnings. If the fair value hedge of interest rate risk is subsequently discontinued, an entity would consider the debt instrument's fair value hedge basis adjustment when prospectively assessing the effectiveness of the net investment hedge.

Amendments to Subtopic 815-20

13. Amend paragraphs 815-20-55-38 and 815-20-55-129, with a link to a transition paragraph 815-20-65-6, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Eligibility of Hedging Instruments

> > Hedging Instruments in Hedges of Foreign Exchange Risk

> > > 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.

Implementation Guidance and Illustrations

> Implementation Guidance

> > Eligibility of Hedged Items

> > > Hedged Items Involving 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. When a foreign-currency-denominated debt instrument is designated as both a hedging instrument and a hedged item, an entity should exclude from the assessment of effectiveness in the net investment hedging relationship the fair value hedge basis adjustment resulting from designating the foreign-currency-denominated debt instrument in the fair value hedge. In those situations, an entity recognizes gains and losses from the remeasurement of the foreign-currency-denominated debt instrument's fair value basis adjustment at the spot exchange rate currently in earnings in accordance with Subtopic 830-20. If the fair value hedge of the foreign-currency-denominated debt instrument is subsequently discontinued in accordance with the guidance in Section 815-25-40, an entity should consider the foreign-currency-denominated debt instrument's fair value hedge basis adjustment when prospectively assessing the effectiveness of the net investment hedge after the date of discontinuing the fair value hedge. Excluding the fair value hedge basis adjustment from the designation of the net investment hedging relationship should not be applied by analogy to other circumstances. Example 10 (see paragraph 815-20-55-127) illustrates ~~this circumstance~~ the circumstances in which a foreign-currency-denominated debt instrument that is designated as the hedging instrument in a net investment hedge also is designated as the hedged item in a fair value hedge of interest rate risk.

> Illustrations

> > 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. Parent A should exclude the fair value hedge basis adjustment from the assessment of effectiveness in the designated net investment hedging relationship. Accordingly, ~~The~~ the notional amount of the debt that is designated as the hedging instrument in the net investment hedge will not change over time as a result of applying fair value hedge accounting such that it may ~~not~~ continue to match the ~~notional amount~~ portion of the net investment being 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. Because the debt's fair value hedge basis adjustment is not included in the assessment of effectiveness of the net investment hedging relationship, the effect of changes in the spot rate on the fair value hedge basis adjustment is recognized currently in earnings in accordance with Subtopic 830-20. ~~As discussed in paragraphs 815-35-35-13 through 35-14, because the notional amount of the nonderivative instrument designated as a hedge of the net investment does not match the portion of the net investment designated as being hedged, hedge effectiveness is assessed 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 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 nonderivative instrument that has a notional amount that matches the portion of the net investment being hedged. The hypothetical nonderivative instrument also would have a maturity that matches the maturity of the actual nonderivative instrument designated as the net investment hedge.~~

Issue 4: Using the Term *Prepayable* under the Shortcut Method

14. The amendments in this proposed Update would replace the term *prepayable* with *early settlement feature* for the purposes of applying the shortcut method.

Amendments to Subtopic 815-20

15. Amend paragraphs 815-20-25-104 and 815-20-25-112 through 25-115 and their related heading, with no link to a transition paragraph, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Hedge Effectiveness

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

> > > Assuming Perfect Hedge Effectiveness 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 hedge effectiveness. If all of the applicable conditions in the list in paragraph 815-20-25-104 are met, an entity may assume perfect effectiveness 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. 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 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 <u>does not have a term, clause, or other provision that is considered an early settlement feature</u> ~~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 <u>has an early settlement feature</u> ~~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.

<u>See paragraphs 815-20-25-112 through 25-114 and 815-20-55-75 through 55-78 for additional guidance on the application of the early settlement feature criterion under the shortcut method.</u>

f. Subparagraph superseded by Accounting Standards Update No. 2017-12.
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.

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 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.

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 contractually specified interest rate designated as the interest rate being hedged for that hedging relationship.

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 the 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 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 in a hedge of interest rate risk.

> > > > Application of ~~Prepayable~~ the Early Settlement Feature Criterion under the Shortcut Method

815-20-25-112 An interest-bearing asset or liability shall be considered ~~prepayable~~ to have an early settlement feature under the provisions of paragraph 815-20-25-104(e) if one party to the contract has the right to cause settlement ~~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 or assumed maturity date if the hedged item is measured in accordance with paragraph 815-25-35-13B 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 or assumed maturity date if the hedged item is measured in accordance with paragraph 815-25-35-13B 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 an early settlement feature ~~a prepayment provision~~:

a. Any term, clause, or other provision in a debt instrument that gives the debtor or creditor the right to cause early settlement ~~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 early settlement ~~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, 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, 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 settled early ~~prepaid~~ at its then fair value would not cause the interest-bearing asset or liability to be considered to have an early settlement feature ~~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 under the shortcut method is illustrated in ~~paragraph~~ paragraphs 815-20-55-75 through 55-78.

16. Amend paragraphs 815-20-55-74 through 55-77 and their related heading, with no link to a transition paragraph, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Hedge Effectiveness

> > > Application of the <u>Early Settlement Feature</u> ~~Prepayable~~ Criterion under the Shortcut Method

815-20-55-74 This implementation guidance discusses the application of the <u>early settlement feature</u> **~~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 <u>early settlement</u> ~~prepayment~~ of the debt (that is, cause the <u>settlement</u> ~~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 <u>early settlement</u> ~~prepayment~~ by the debtor at a fixed amount, for example, at par or at a specified premium over par. In some instruments, the <u>settlement</u> ~~prepayment~~ amount varies based on when the call option is exercised. <u>Those</u> ~~Fixed-rate~~ debt instruments ~~that provide the borrower with the option to prepay at a fixed amount~~ are considered <u>to have an early settlement feature at a fixed amount</u> ~~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 to have an early settlement feature ~~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 to have an early settlement feature ~~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 settling ~~prepaying~~ the debt early 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 settling ~~prepaying~~ the debt early 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 settles ~~prepays~~ the debt early, 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 to have an early settlement feature ~~prepayable~~ under paragraph 815-20-25-104(e), because it involves settlement of the entire contract by the debtor before its stated maturity or assumed maturity date if the hedged item is measured in accordance with paragraph 815-25-35-13(b) 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 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 settle ~~prepay~~ the variable-rate debt instrument at par at that reset date would not be considered an early settlement feature ~~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 settle ~~prepay~~ the variable-rate debt instrument at par at a reset date would be considered an early settlement feature ~~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 settled early ~~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 early settlement ~~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 call ~~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 options ~~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 call ~~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 early settlement ~~prepayment~~ and interest rate adjustment clauses that protect the issuer and investors. Illustrative debt instrument 7 is not considered to have an early settlement feature ~~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 considered to have an early settlement feature ~~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 to have an early settlement feature ~~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**.**

17. Add paragraph 815-20-65-6 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2020-XX, *Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting*

815-20-65-6 The following represents the transition and effective date information related to Accounting Standards Update No. 2020-XX, *Derivatives and Hedging (Topic 815)*: *Codification Improvements to Hedge Accounting:*

a. The pending content that links to this paragraph shall be effective for all entities for fiscal years beginning after December 15, 2020. For **public business entities**, the pending content that links to this paragraph shall be effective for interim periods within fiscal years beginning after December 15, 2020. For all other entities, the pending content that links to this paragraph shall be effective for interim periods within fiscal years beginning after December 15, 2021. See (c), (d), (e), and (f) for additional transition guidance for entities that have adopted the amendments in Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities*, before the adoption of the amendments in Update 2020-XX. See (g) for additional transition guidance for entities that adopt the amendments in Update 2020-XX when they adopt the amendments in Update 2017-12. Early adoption is permitted for all entities on any date on or after the issuance of Update 2020-XX if an entity has adopted the amendments in Update 2017-12.
b. For existing **cash flow hedges** (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) at the date of adoption of the amendments in Update 2020-XX, an entity shall amend its hedge documentation, without dedesignation, to include the method to be used

to identify a hedged **transaction** with an undocumented hedged risk after the transaction occurred if applying the guidance in paragraph 815-30-35-37C in accordance with paragraph 815-20-25-3(d)(1)(ix).

c. For an entity that has adopted the amendments in Update 2017-12 before the effective date of the amendments in Update 2020-XX, that entity may elect to reflect all of the pending content that links to this paragraph on a prospective basis from the date of adoption of the amendments in Update 2020-XX or on a retrospective basis to the date of adoption of the amendments in Update 2017-12 in accordance with paragraph 815-20-65-3 for all affected transactions, with the following exception:
   1. For hedges of a foreign-currency-denominated debt instrument as both the hedging instrument in a net investment hedge and the hedged item in a **fair value hedge** of **interest rate risk** in accordance with paragraph 815-20-55-38 that were existing as of the adoption date of the amendments in Update 2017-12, the entity shall reclassify the amount of the remeasurement of the foreign-currency-denominated debt instrument's fair value hedge basis adjustment that was reclassified to the cumulative translation adjustment section of accumulated other comprehensive income upon initial application of the amendments in Update 2017-12 to retained earnings as of the date of initial application of the amendments in Update 2017-12. For hedges of a foreign-currency-denominated debt instrument as both the hedging instrument in a net investment hedge and the hedged item in a fair value hedge of interest rate risk in accordance with paragraph 815-20-55-38 that were existing as of the date of adoption of the amendments in Update 2017-12 or designated between the adoption date of the amendments in Update 2017-12 and the adoption date of the amendments in Update 2020-XX, the entity shall reclassify the remeasurement of the foreign-currency-denominated debt instrument's fair value hedge basis adjustment that was recognized in **other comprehensive income** after the initial application date of the amendments in Update 2017-12 to earnings in the corresponding period or periods in which it was recognized in other comprehensive income. For those hedges existing at the date of adoption of the amendments in Update 2020-XX, the entity also shall amend its documentation for those hedging relationships without dedesignation to exclude the fair value hedge basis adjustment from the assessment of effectiveness in accordance with paragraph 815-20-55-38.

d. For an entity that has adopted the amendments in Update 2017-12 before the effective date of the amendments in Update 2020-XX and reflects the amendments on a retrospective basis in accordance with (c), the entity may make the following elections:
   1. For hedges of overall changes in cash flows of forecasted purchases or sales of nonfinancial assets existing as of the adoption date of the

amendments in Update 2017-12 that would have qualified for **contractually specified component** risk hedging in accordance with paragraphs 815-20-25-22C through 25-22E, the entity may apply the guidance in paragraph 815-20-65-3(e)(6).

2. For hedges of overall changes in cash flows of forecasted purchases or sales of nonfinancial assets designated between the adoption date of the amendments in Update 2017-12 and the adoption date of the amendments in Update 2020-XX that would have qualified for contractually specified component risk hedging in accordance with paragraphs 815-20-25-22C through 25-22E, the entity may:
   i. Modify the hedging relationship, without dedesignation, to specify that the hedged risk is the variability in the contractually specified component.
   ii. Create the terms of the instrument used to estimate change in value of the hedged risk (under either 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.
3. For hedges of overall changes in cash flows described in (d)(1) and (d)(2) that were assessed to be not highly effective in a subsequent effectiveness assessment after the date of adoption of the amendments in Update 2017-12 but would have been highly effective if the hedged risk were designated as the variability in a contractually specified component, the entity may continue hedge accounting if all other requirements for hedge accounting are met and shall reclassify amounts recognized in earnings after dedesignation to accumulated other comprehensive income or to the same income statement line item as the earnings effect of the hedged **forecasted transaction**, as appropriate, in the appropriate periods.
4. For cash flow hedges that were dedesignated in which the entity reclassified amounts from accumulated other comprehensive income to earnings in accordance with paragraph 815-30-40-5 between the adoption date of the amendments in Update 2017-12 and the adoption date of the amendments in Update 2020-XX, the entity may apply the change in hedged risk guidance in paragraphs 815-30-35-37A through 35-37C and the related implementation guidance in paragraphs 815-30-55-1G through 55-1V to those hedging relationships. In that case, amounts previously recorded in earnings in accordance with paragraph 815-20-45-1B shall be reclassified within earnings in accordance with paragraph 815-20-45-1A or to accumulated other comprehensive income, as appropriate, in the appropriate periods. Cash flow hedging relationships adjusted in accordance with paragraph 815-20-65-6(d)(4) such that there is no shortfall in the hedged forecasted transaction shall not be considered in determining whether there is a

pattern of the hedged forecasted transaction being **probable** of not occurring. The entity shall amend its hedge documentation without dedesignation to include the method to be used to identify a hedged transaction with an undocumented hedged risk after it occurred if applying the guidance in paragraph 815-30-35-37C in accordance with paragraph 815-20-25-3(d)(1)(ix) for hedging relationships adjusted by paragraph 815-20-65-6(d)(4).

5. The entity may retrospectively designate new hedging relationships between the date of adoption of the amendments in Update 2017-12 and the adoption date of the amendments in Update 2020-XX for existing eligible hedging instruments and existing eligible recognized assets or liabilities or existing eligible forecasted transactions related to the amendments in paragraph 815-20-25-15B, paragraphs 815-20-25-22C through 25-22E, or paragraph 815-20-55-38.

e. For a cash flow hedge existing as of the date of adoption of the amendments in Update 2020-XX in which the amendments in paragraph 815-20-25-79B affect the assessment of hedge effectiveness, an entity may elect on a hedge-by-hedge basis to rebalance the hedging relationship by either increasing or decreasing the designated **notional amount** of the hedging instrument. For a hedge that existed as of the adoption date of the amendments in Update 2020-XX and that also existed as of the date of adoption of the amendments in Update 2017-12, an entity shall recognize the cumulative effect of changing the designated notional amount of the hedging instrument as an adjustment to the opening balance of retained earnings and accumulated other comprehensive income as of the initial application date of the amendments in Update 2017-12. For a hedge that existed as of the adoption date of the amendments in Update 2020-XX and that also existed as of the date of adoption of the amendments in Update 2017-12 or was designated between the adoption date of the amendments in Update 2017-12 and the adoption date of the amendments in Update 2020-XX and that also existed as of the adoption date of the amendments in Update 2020-XX, an entity shall reclassify the appropriate amount of hedging instrument gains or losses to earnings or other comprehensive income after the initial application date of the amendments in Update 2017-12 in the corresponding period or periods in which it was recognized in either income or other comprehensive income. The entity shall amend its documentation of the hedging relationship without dedesignation to reflect the rebalanced amount. If the guidance in paragraph 815-20-25-79B does not affect the assessment of hedge effectiveness for a hedge existing as of the date of adoption of the amendments in Update 2020-XX, no transition adjustments in accordance with paragraph 815-20-65-6(e) shall be applied to that hedging relationship.

f. For an entity that has adopted the amendments in Update 2017-12 before the effective date of the amendments in Update 2020-XX and reflects the amendments on a prospective basis in accordance with (c), for hedges of overall changes in cash flows of forecasted purchases or sales of nonfinancial assets existing as of the adoption date of the amendments in Update 2020-XX that qualify for contractually specified component risk hedging in accordance with paragraphs 815-20-25-22C through 25-22E, the entity may:

1. Modify the hedging relationship, without dedesignation, to specify the hedged risk is the variability in the contractually specified component.
2. Create the terms of the instrument used to estimate change in value of the hedged risk (under either 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.

g. For an entity that adopts the amendments in Update 2020-XX on the date it adopts the amendments in Update 2017-12, for existing cash flow hedges at the date of adoption of the amendments in Update 2020-XX, the entity may elect to apply the guidance in (e). That entity shall apply the guidance in paragraph 815-20-55-38 on the date of initial application of the amendments in Update 2017-12 and the guidance in paragraphs 815-20-25-22A through 25-22E and 815-20-25-84 in accordance with paragraph 815-20-65-3(e)(6).

h. An entity shall disclose the following in the period that it adopts the pending content that links to this paragraph:

1. The nature of and reason for the change in accounting principle.
2. The method of applying the change. For an entity that adopted the amendments in Update 2017-12 before the issuance of Update 2020-XX, the disclosure of whether the entity adopted the eligible amendments in accordance with (c) either on a prospective or retrospective basis is required.
3. The effect of the adoption on any line item in the statement of financial position, if material, as of the beginning of the first period for which the pending content that links to this paragraph is effective. Presentation of the effect on financial statement subtotals is not required.
4. The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the first period for which the pending content that links to this paragraph is effective.

i. An entity that issues interim financial statements shall provide the disclosures in (g) in each interim financial statement of the fiscal year of change and the annual financial statement of the fiscal year of change.

The amendments in this proposed Update were approved for publication 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
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. The Board issued Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* to more closely align hedge accounting with an entity's risk management activities and to make certain targeted improvements to simplify the application of the hedge accounting guidance on the basis of feedback received from preparers, auditors, users, and other stakeholders. Since the issuance of the new hedging standard in August 2017, the Board has been educating and assisting stakeholders with implementation questions and issues as organizations adopt the new guidance.

BC3. Since the issuance of Update 2017-12, some stakeholders have asked the Board to clarify aspects of the new guidance in relation to the following topics:

a. Change in hedged risk in a cash flow hedge
b. Contractually specified components in cash flow hedges of nonfinancial forecasted transactions
c. Foreign-currency-denominated debt instrument as hedging instrument and hedged item (dual hedge)
d. Using the term *prepayable* under the shortcut method.

BC4. A discussion of those issues and the Board's basis for conclusions for addressing those issues are provided below.

Benefits and Costs

BC5. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC6. Because hedge accounting is optional within GAAP, not all entities would bear the costs of implementing the amendments in this proposed Update. For entities that elect to apply hedge accounting, the Board does not anticipate that they will incur significant costs as a result of the proposed amendments. However, the Board acknowledges that certain reporting entities would incur implementation costs, particularly related to implementing the change in hedged risk guidance. Those costs may include initial costs to educate employees, establish new accounting methods, and update systems and processes.

BC7. The Board believes that after implementing the amendments in this proposed Update, entities would have minimal, if any, incremental costs to comply with the proposed amendments on an ongoing basis. Moreover, the Board believes that entities largely would be able to leverage existing systems and processes. The proposed amendments would provide the benefit of improving consistent application of GAAP by clarifying guidance that already exists within GAAP. The Board also believes that the clarity provided by the proposed amendments would result in a more faithful representation of hedging activities in a cost-efficient manner for preparers.

Basis for Conclusions

Issue 1: Change in Hedged Risk in a Cash Flow Hedge

BC8. The amendments in Update 2017-12 added paragraph 815-30-35-37A, which allows an entity to retain hedge accounting if the hedged risk in a cash flow hedge changes and the derivative designated as the hedging instrument remains highly effective. That paragraph further clarifies that a change in the hedged risk is not considered a change in a critical term of a hedging relationship that would result in an automatic dedesignation. To accommodate an entity changing its hedged risk after hedge inception, the amendments in Update 2017-12 also revised paragraph 815-20-55-23 to require that transactions hedged in a group share the risk exposure for which they are being hedged only at the time of hedge designation rather than throughout the life of the hedging relationship.

BC9. After the issuance of Update 2017-12, stakeholders asked the Board to clarify how the change in hedged risk guidance in paragraphs 815-30-35-37A and the consequential amendments to the shared risk exposure guidance in paragraph 815-20-55-23 should be implemented. Stakeholders asked about perceived inconsistencies and unintended consequences resulting from the change in hedged risk guidance. The Board decided to clarify those issues in the amendments in this proposed Update. The primary issues addressed in these proposed amendments include the following:

a. Distinguishing the forecasted transaction from the hedged risk
b. Designating an entity's best estimate of the hedged risk expected to occur in the forecasted transaction
c. Identifying the forecasted transaction when it occurs
d. Assessing hedge effectiveness
e. Assessing shared risk exposure for forecasted transactions hedged in a group
f. Scope.

Distinguishing the Forecasted Transaction from the Hedged Risk

BC10. The Board decided to explicitly clarify in the proposed implementation guidance that the forecasted transaction is distinct from the hedged risk. That clarification is consistent with the basis for conclusions in Update 2017-12 that indicates that a change in a designated hedged risk is not a missed forecast in accordance with paragraphs 815-30-40-4 through 40-6. The missed forecast guidance in those paragraphs requires that an entity immediately reclassify to earnings amounts deferred in accumulated other comprehensive income if it becomes probable during the life of the hedging relationship that the forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period thereafter, except in rare cases.

BC11. The Board believes that an entity should not consider the hedged risk in determining whether to apply the missed forecast guidance. Moreover, the Board believes that the concepts are separable regardless of the manner in which an entity documents the forecasted transaction and hedged risk. Accordingly, the Board believes that an entity can meet the specificity requirements for documenting the forecasted transaction in accordance with paragraph 815-20-25-3(d)(1)(i) through (vi) without referencing the hedged risk. The amendments in this proposed Update would not allow the forecasted transaction to change to one that was not documented at hedge inception. For that reason, the Board believes that it is important to distinguish between the forecasted transaction and hedged risk.

BC12. The Board acknowledges that hedges of interest rate risk may have the unique attribute of tenor that is not present in hedges of forecasted purchases and sales of nonfinancial items. The Board also understands that the number and timing of forecasted interest payments often are determined by the tenor of the hedged interest rate risk. The proposed amendments in paragraph 815-30-55-1M(a) clarify that interest rate tenor should be considered part of the hedged risk. Additionally, because of the linkage between tenor and the number and timing of interest payments, the proposed amendments in paragraph 815-30-35-37D would clarify that the number and timing for forecasted interest payments may change as a result of a change in the hedged risk as long as the revised payments occur within the hedge period. Thus, a change in the tenor of an interest rate that results in a change in the number and timing of interest payments would be considered a change in hedged risk, not a change in the forecasted transaction. Accordingly, if the hedged risk changes to a different tenor but all interest settlements occur in the originally specified time period, an entity would not apply the missed forecast guidance in paragraphs 815-30-40-4 through 40-6.

BC13. For hedges of interest rate risk, the Board believes that changing the number and timing of the forecasted transactions within the hedge period is a consequence of a change in the hedged risk and that, without allowing those changes, the amendments in this proposed Update would not accomplish the Board's objective of avoiding a missed forecast when the forecasted transaction occurs.

BC14. For example, if an entity designated the hedged risk on a 1-year note as an interest rate with a 1-month tenor with payments settling at month end but subsequently changed it to an interest rate with a 3-month tenor with payments settling at quarter end, by year-end the entity would have paid interest for all 12 months in the year. In those cases, the Board believes that it would be inappropriate for an entity to consider such a change to be a missed forecast and, consequentially, call into question its ability to apply hedge accounting to similar forecasted transactions in the future. In addition, the Board believes that the highly effective threshold provides sufficient limitations to the degree to which the number and timing of forecasted transactions can change.

Designating an Entity's Best Estimate of the Hedged Risk Expected to Occur in the Forecasted Transaction

BC15. The amendments in this proposed Update would clarify that different criteria apply to the forecasted transaction and the hedged risk. Specifically, the proposed amendments to paragraphs 815-20-25-3(d)(1)(vii) through (viii) and 815-20-25-19A(b) would clarify that the hedged risk documented at hedge inception should represent an entity's best estimate of the risk expected to cause variability in cash flows associated with the forecasted transaction when it occurs.

BC16. The Board believes that a best estimate threshold would allow an entity to change a forecasted transaction's hedged risk as facts and circumstances surrounding the transaction change without recording a missed forecast. The Board intended for that flexibility to be permitted in rejecting the alternative considered during deliberations on Update 2017-12 (and discussed in paragraphs BC66–BC68 of the basis for conclusions of that Update) that would have considered a change in hedged risk a missed forecast.

BC17. The Board decided to supersede the guidance in paragraph 815-20-25-19B that requires that an entity designate a benchmark interest rate as the hedged risk when it is uncertain whether it will issue or purchase a fixed-rate or variable-rate debt because that guidance may conflict with the proposed amendment that would require that an entity designate its hedged risk best estimate. For example, if an entity is uncertain at hedge inception whether it will issue fixed-rate or variable-rate debt but its best estimate is that it will issue variable-rate debt with a contractually specified interest rate that is not a benchmark rate, the amendments in this proposed Update would require that the entity designate the contractually specified interest rate that is not a benchmark rate as its hedged risk best estimate. If the entity determines after hedge inception that it will issue fixed-rate debt, then it would have to change its hedged risk to an eligible benchmark rate and assess whether the hedging instrument remains highly effective to continue to qualify for hedge accounting. That change would be permitted under the proposed change in hedged risk guidance.

BC18. The amendments in this proposed Update also would allow the hedged risk to change from one benchmark rate to another if hedging the forecasted issuance or purchase of a fixed-rate debt instrument. The Board received stakeholders' feedback that certain situations may arise that could necessitate a change in the benchmark rate hedged in a forecasted purchase or issuance of fixed-rate debt, which may include, but are not limited to:

a. Issuing or purchasing debt in a currency other than the currency expected at hedge inception (for example, issuing debt based on USD London Interbank Offered Rate [LIBOR] instead of the Euro Interbank Offered Rate [EURIBOR])
b. Issuing or purchasing debt with a different maturity date than expected (for example, issuing debt based on the 5-year benchmark rate instead of the 10-year benchmark rate)
c. Reference rate reform when the hedging instrument changes to a different benchmark rate or the originally designated benchmark rate is no longer quoted as a result of regulatory actions (for example, the derivative hedging the forecasted issuance of fixed-rate debt changing rates from LIBOR to the Secured Overnight Financing Rate [SOFR] or LIBOR no longer is quoted).

BC19. The Board decided that the hedged risk can change in a forecasted issuance or purchase of a fixed-rate debt instrument because it believes that a change in a benchmark rate hedged risk is conceptually no different from a change in a contractually specified interest rate hedged risk in a hedge of variable-rate debt. In both circumstances, the forecasted transactions (that is, interest payments) remain probable but the risk those payments are subject to changes. The proposed amendments would continue to allow an entity to designate any eligible benchmark rate if its best estimate is that it will issue or purchase fixed-rate debt. However, if there are changes in facts and circumstances that warrant a change in the benchmark rate or a change in the currency (for example, from USD LIBOR to EURIBOR) or duration (see Example 16 in paragraph 815-30-55-94) associated with the benchmark rate after hedge inception, the proposed amendments would allow those changes to be accounted for under the change in hedged risk guidance.

BC20. The Board intends for entities to apply the best estimate concept in the context of the change in hedged risk guidance similarly to how they apply the best estimate concept in the context of the timing of the forecasted transaction under current GAAP in accordance with paragraph 815-20-25-16(d). That is, an entity's best estimate of its hedged risk would be its good-faith judgment of the risk expected to be present in the forecasted transaction based on the facts and circumstances surrounding the forecasted transaction as opposed to a statistical or probability-weighted assessment. The amendments in this proposed Update would require that an entity reassess its best estimate of the hedged risk expected to be present in the forecasted transaction at a minimum at each quarterly assessment period.

BC21. The Board believes that this proposed amendment would address the risk of an entity willfully delaying a revision to its best estimate if the entity's revised hedged risk no longer would have qualified for hedge accounting. The Board believes that reevaluating an entity's best estimate of the hedged risk would naturally align with its ongoing assessment of whether the forecasted transaction remains probable of occurring. Thus, the Board believes that the proposed reevaluation requirement would not impose a significant incremental burden on preparers.

BC22. In the amendments in Update 2017-12, the Board provided relief related to the timing of when hedge effectiveness testing should be performed, which allows certain private and not-for-profit entities to defer initial and ongoing assessments of hedge effectiveness to the date on which the next interim (if applicable) or annual financial statements are available to be issued. The Board decided that it would not extend similar relief related to the timing of when those private companies and not-for-profit entities would be required to reassess the best estimate of the hedged risk expected to be present in the forecasted transactions.

BC23. The Board believes that the complexity and resource requirements involved in effectiveness testing that were its basis for providing timing relief in the amendments in Update 2017-12 are not comparable to those that are involved in an entity reevaluating its best estimate of its hedged risk. In addition, the Board believes that management's understanding of the risk to which it is most likely exposed is integral to management's execution of its risk management strategies.

BC24. Moreover, through stakeholder outreach, the Board understands that many private companies and not-for-profit entities that use the timing relief provided in the amendments in Update 2017-12 are hedging the variability in interest payments associated with variable-rate borrowings. In those interest rate risk hedges, management should be able to determine whether a change in hedged risk occurred on the basis of facts and circumstances relevant to an entity's daily operations. For example, management would know immediately if it refinanced its debt and is now paying interest at a different interest rate. Thus, the Board decided not to provide private companies and not-for-profit entities with relief to delay the reassessment of their hedged risk best estimate because it believes that the relief would be unnecessary.

BC25. The Board does not intend for the amendments in paragraph 815-30-55-1M in this proposed Update to preclude an entity from including forecasted transactions with different best estimates of the hedged risk in the same portfolio hedge. For example, an entity may execute a portfolio hedge and wish to identify forecasted transactions as the first interest payments received related to a designated amount of loan notional in a specific month with the designated hedged risk of LIBOR. In that circumstance, the proposed amendments would allow an entity to identify LIBOR interest payments of all tenors that qualify as forecasted transactions as the hedged forecasted transactions when they occur. To qualify as a forecasted transaction, the transaction would have to conform to an entity's description of the forecasted transaction as documented at hedge inception. Moreover, if LIBOR is designated broadly to include all tenors of the index, the entity would need to assess hedge effectiveness in accordance with paragraph 815-20-25-79B and to assess shared risk exposure in accordance with paragraph 815-20-55-23 for all forecasted transactions in the hedged portfolio.

BC26. The amendments in paragraph 815-20-55-23A in this proposed Update clarify that the Board believes that it would be inappropriate for an entity to assume that its best estimate of the hedged risk for the majority of forecasted transactions in the portfolio applies to all forecasted transactions in the group. The Board believes that if an entity were to make that assumption, it would be circumventing the guidance on shared risk exposure in portfolio hedges.

BC27. For example, if an entity groups forecasted purchases of 1,000 bushels of soybeans together in a portfolio hedge and its hedged risk best estimate for 700 bushels is the ABC soybean index while its best estimate for the remaining 300 bushels is the XYZ soybean index, an entity would not be permitted to designate the ABC soybean index as its hedged risk best estimate for all 1,000 forecasted soybean purchases. To allow that assumption could potentially allow forecasted transactions with offsetting risks to be hedged in a single portfolio, which was not the Board's intent in clarifying the change in hedged risk guidance in Update 2017-12.

BC28. The Board believes that each forecasted transaction can have only one best estimate and that should be the hedged risk designated. The Board continues to reject the alternative considered during deliberations on Update 2017-12 that would have required that multiple potential hedged risks in addition to an entity's best estimate be documented and assessed for effectiveness at hedge inception and thereafter. The Board continues to believe that the alternative is too operably burdensome to achieve limited relief from recording a missed forecast.

BC29. Under that alternative, an entity would still have been limited to considering documented hedged risks and would have recorded a missed forecast if the hedged risk would have changed to an undocumented hedged risk. The Board understands that this rejected alternative may still be used in practice by entities that have adopted the amendments in Update 2017-12. However, as discussed in paragraph BC66 of Update 2017-12, the Board was aware that its decision could result in a change in practice.

Identifying the Hedged Forecasted Transaction When It Occurs

BC30. Current GAAP requires that an entity document its hedged forecasted transaction in such a way that it can identify the hedged forecasted transaction when it occurs. That requirement ensures that amounts deferred in accumulated other comprehensive income are linked to transactions that ultimately will affect earnings. While the amendments in this proposed Update would clarify that the forecasted transaction and hedged risk are distinct, they also would indicate that an entity should first look to its documented hedged risk to identify hedged forecasted transactions when they occur. Consequently, if there is no shortfall or expected shortfall in forecasted transactions occurring with the documented hedged risk, the entity would not apply the change in hedged risk guidance. That is, if the entity does not experience or expect a shortfall in forecasted transactions occurring with the documented hedged risk, no changes would be made to the entity's current hedge accounting practices.

BC31. If an entity's best estimate of its hedged risk changes before the forecasted transaction occurs, the amendments in this proposed Update would require that the entity add an addendum to its initial hedge documentation at that time to indicate that hedge effectiveness testing for periods beginning thereafter should be performed with the revised hedged risk. Thus, regardless of whether the hedged risk has changed, the entity would look to its documented hedged risk to identify forecasted transactions when they occur in all situations except for those in which it is applying the change in hedged risk guidance using hindsight (that is, in accordance with the proposed amendments in paragraph 815-30-35-37C).

BC32. Hindsight would be used to identify hedged transactions after they occurred. The latest date on which an entity could identify a hedged transaction using hindsight would be as of the end of the additional two-month period after the specified hedged period discussed in paragraph 815-30-40-4. Hindsight would be used to identify transactions that occurred with hedged risks that were not included in initial hedge documentation or in an addendum to that documentation. An entity would identify hedged transactions using hindsight if the entity's best estimate is that it will no longer fulfill the designated quantity of forecasted transactions with forecasted transactions based on the documented hedged risk. This could be before the end of the hedge period or the end of the additional two-month period.

BC33. For example, if halfway through the hedge period an entity identifies that its hedged risk has changed but not all forecasted transactions have occurred, then it would revise its hedged risk best estimate for forecasted transactions yet to occur (applying the guidance in paragraphs 815-30-35-37A through 37B). In that instance, if probable forecasted transactions with the revised hedged risk are insufficient to fulfill the designated amount of forecasted transactions documented at hedge inception, then the entity would identify hedged transactions that already occurred using hindsight in accordance with its designated method (in accordance with paragraph 815-30-35-37C) at that point in time.

BC34. Stakeholders asked that the Board clarify how an entity can meet the requirement to identify the hedged forecasted transaction when it occurs when applying the change in hedged risk guidance using hindsight. The amendments to paragraph 815-20-25-3(d)(1)(vi) in this proposed Update would address that issue by clarifying that the forecasted transaction must be documented with sufficient specificity such that an entity can identify a transaction that is *eligible* to be identified as hedged when it occurs, regardless of the hedged risk.

BC35. For example, an entity cannot designate the last 15,000 units sold in a given period as the forecasted transactions because the entity would not be able to determine at the time that the sale occurs whether it will be one of the last 15,000 in the period. In contrast, an entity can designate the first 15,000 units sold in a given period as the forecasted transactions because the entity would know at the time that the forecasted transaction occurs that it could be identified as hedged.

BC36. To determine whether an eligible transaction should, in fact, be identified as the hedged forecasted transaction when it occurs, an entity would look to its documented hedged risk. If an eligible transaction occurs with the documented hedged risk, then the transaction would be identified as the hedged forecasted transaction when it occurs. In other words, not all eligible transactions may be identified as the hedged forecasted transactions when they occur (that is, those without the designated hedged risk would not be identified as the hedged forecasted transactions when they occur), but all transactions that are ultimately identified as the hedged forecasted transactions (whether identified when they occur or subsequently using hindsight) must be eligible.

BC37. For example, if an entity identifies a change in hedged risk after eligible transactions occurred but before the end of the hedge period, the entity would know which transactions that have occurred to date should be included in the population of the transactions to which it applies its hindsight identification method. The amendments in this proposed Update would eliminate the need to include the hedged risk in the description of the forecasted transaction.

BC38. The Board believes that the amendments in this proposed Update to the guidance on identifying a hedged transaction when it occurs are necessary because entities designating and reassessing their hedged risk best estimates in good faith should not have the ability to hedge similar forecasted transactions compromised when the hedged risk changes. Through outreach, the Board understands that a hedged risk could change as a result of natural disasters, international trade disputes, elective changes in suppliers, or suppliers exercising their control over pricing terms, among other reasons. The Board decided that it would allow an entity to identify a hedged transaction after it occurred because it believes that an entity should not record a missed forecast when the forecasted transaction occurred. However, the Board believes that it would be inappropriate to apply the change in hedged risk guidance when no shortfall exists in forecasted transactions with the designated hedged risk. If no such shortfall is expected, an entity could change the hedged risk by dedesignating the existing hedging relationship and redesignating a new hedging relationship with a different hedged risk.

BC39. The amendments in this proposed Update would require an entity applying the change in hedged risk guidance using hindsight to identify hedged transactions in a consistent manner for similar hedging relationships. That guidance differs from the guidance for identifying hedged transactions if the forecasted transaction has not yet occurred, in which case the proposed amendments in paragraphs 815-30-35-37A through 35-37B would indicate that the entity must identify hedged transactions on the basis of its revised best estimate of the hedged risk expected to be present in the forecasted transaction when it occurs.

BC40. The Board believes that different guidance is necessary when identifying a hedged transaction using hindsight because an entity’s hedged risk best estimate was not present in the transaction when it occurred. When there are no transactions to identify with the designated hedged risk, the Board believes that there are different methods that an entity may wish to use to identify hedged transactions using hindsight on the basis of its unique risk management strategies. To accommodate a variety of methods, the Board decided that it would require that an entity document a hindsight identification method at hedge inception that the entity would use to determine which transactions that already occurred should be identified as hedged transactions in instances in which hindsight must be applied. The Board believes that hindsight identification methods should be reasonable but could vary with the nature of an entity’s business, its hedging relationships, and risk management strategies. Accordingly, the proposed amendments in paragraph 815-30-35-45A place no explicit limitations on the attributes of the forecasted transaction that can be the basis for an entity’s hindsight identification method.

BC41. The Board considered, but rejected, an alternative that would have permitted an entity to identify hedged transactions using hindsight only if the hedged transactions identified had a revised risk that would have retrospectively tested highly effective. Forecasted transactions with risks that would not have tested highly effective could not have fulfilled the shortfall in hedged transactions. Consequently, an entity unable to fulfill the shortfall with transactions that would have resulted in highly effective hedging relationships would have recorded a missed forecast.

BC42. Consistent with the Board's basis for conclusions in Update 2017-12, the Board believes that it is inappropriate for an entity to record a missed forecast when sufficient forecasted transactions occur to fulfill the amount documented as hedged at inception. Additionally, that alternative would have violated the principle that the forecasted transaction is distinct from the hedged risk. It also would have created different effectiveness criteria when identifying hedged transactions using hindsight versus not using hindsight. The Board believes that this would have been an arbitrary distinction.

BC43. The Board also considered, but rejected, another alternative that would have required that an entity immediately reclassify deferred amounts from accumulated comprehensive income to the same income statement line item as the earnings effect of the hedged item if the hedged transaction was identified using hindsight and the hedging relationship retrospectively did not test highly effective. Under that alternative, an entity would not have recorded a missed forecast because the forecasted transaction occurred. If the forecasted transaction occurred with a revised hedged risk that resulted in a hedging relationship that did not test highly effective retrospectively, the entity would have had to reclassify the appropriate amount from accumulated other comprehensive income such that the balance in accumulated other comprehensive income reflected the same amount that it would have had if the entity had identified the change in hedged risk when it occurred and immediately dedesignated the hedging relationship.

BC44. The Board rejected that alternative because it believes that the operational complexity involved in reperforming hedge effectiveness assessments with the revised hedged risk would not justify the benefit of accelerating the earnings recognition of amounts deferred in accumulated other comprehensive income related to hedged transactions that retrospectively would not have tested highly effective. That decision is consistent with the Board's decision that would require that an entity assess hedge effectiveness with the revised hedge risk only for periods in which the revised hedged risk is its then-best estimate.

BC45. The Board acknowledges that the alternative that it supports for applying the change in hedged risk guidance using hindsight could result in amounts being deferred in accumulated other comprehensive income related to hedging relationships that would not have tested highly effective since hedge inception. However, the Board believes that an entity that designates its best estimate of the hedged risk expected to be present in the forecasted transactions in good faith should not be penalized with a missed forecast if the entity identifies after the hedged transaction occurred that the hedged risk changed. Moreover, as discussed in paragraph BC28, the Board rejected the alternative that multiple potential hedged risks be documented and assessed for effectiveness at inception and thereafter because of operational complexity.

BC46. The Board also considered, but rejected, an alternative that would have prohibited an entity from identifying hedged transactions that already affected reported earnings. The Board's decision was similarly based on the principle that it would be inappropriate for an entity to record a missed forecast when the forecasted transaction as initially expected and documented occurred. In addition, the Board believes that such an outcome could have arbitrarily disadvantaged certain entities. For example, an entity that hedges a contractually specified component of its inventory purchases and turns its inventory quickly potentially could record more missed forecasts under that alternative compared with an entity that turns its inventory more slowly.

BC47. Because the amendments in this proposed Update would allow the identification of hedged transactions that affected reported earnings in a prior period, the Board added proposed guidance in paragraph 815-30-55-1V to describe the accounting that would result in that scenario. That guidance would require that an entity reclassify in the current period amounts deferred in accumulated other comprehensive income to the same income statement line item as the earnings effect of the hedged forecasted transaction when the entity identifies that the hedged transactions affected prior-period reported earnings.

BC48. The Board acknowledges that the timing of the reclassification to earnings would be the same under this alternative as it would have been had the entity recorded a missed forecast. However, the Board believes that it is preferable to present the earnings effect of the hedge in the same income statement line item as the earnings effect of the hedged forecasted transaction if the forecasted transaction occurred even if there is a mismatch in the period of recognition.

Assessing Hedge Effectiveness

BC49. The guidance on prospective quantitative effectiveness assessment in current GAAP requires that an entity use probability-weighted cash flows to determine expected cash flows attributable to the hedged forecasted transaction. That guidance also indicates that the calculation of expected forecasted cash flows uses a technique consistent with determining fair value. That technique could be interpreted to require that an entity consider all potential hedged risks and would be inconsistent with the proposed change in hedged risk guidance that would require that an entity use only future cash flows on the basis of its designated best estimate of the hedged risk when assessing hedge effectiveness.

BC50. To resolve that inconsistency, the proposed amendments would require that the prospective assessment of hedge effectiveness in a cash flow hedge be based solely on an entity's designated hedged risk best estimate such that it would conform with the proposed change in hedged risk guidance. Those amendments in this proposed Update would apply only to cash flow hedges within the scope of the change in hedged risk guidance (that is, hedges of foreign exchange risk and credit risk would not be within the scope of the proposed amendments on assessing hedge effectiveness). However, for all cash flow hedges, an entity would still be required to probability-weight cash flows for features embedded in the forecasted transaction of the same risk class as the hedged risk, such as the probability that an embedded floor or cap could be triggered in a hedge of interest rate risk.

BC51. In addition, current GAAP has conflicting guidance on how to perform the retrospective assessment of hedge effectiveness when the hedged risk changes. The amendments in this proposed Update to the hedge effectiveness criteria in Subtopic 815-20 would clarify that an entity would only test effectiveness with the hedged risk that was an entity's best estimate during the period being assessed, which is consistent with the examples in paragraphs 815-30-55-1B through 55-1F and paragraphs 815-30-55-52 through 55-62 in current GAAP. The entity would not be required to retrospectively test effectiveness with the revised hedged risk for periods before the change in hedged risk was identified. If no periods remain in the hedging relationship, the entity would not be required to test effectiveness with the revised hedged risk. If hedge periods remain and the revised risk prospectively tests highly effective, the entity would test hedge effectiveness with the revised hedged risk retrospectively for the periods during which the revised hedged risk was its best estimate (that is, beginning after the change in hedged risk was identified).

BC52. The Board decided that if assessing hedge effectiveness with the revised hedged risk, an entity should 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 Topic 815-30, Derivatives and Hedging—Cash Flow Hedges) on the basis of market data as of hedge inception, which would eliminate any off-market components of the forecasted transaction attributable to the passage of time.

BC53. Under the amendments in this proposed Update, an entity may identify that the hedged risk changed after the forecasted transactions occurred. In those situations, the entity would evaluate retrospective hedge effectiveness using its previously documented hedged risk, which was its good-faith best estimate of its hedged risk over the course of the previous assessment period. That test would incorporate any changes in the forecasted transaction other than the hedged risk that occurred since hedge designation (for example, changes in quantity, timing, or counterparty credit risk). Prospectively, if any assessment periods remain, an entity would assess hedge effectiveness with the revised hedged risk because that would be its good-faith best estimate for future periods.

BC54. An identified change in hedged risk also would trigger a final retrospective effectiveness assessment using the documented hedged risk and the first prospective assessment using the revised hedged risk if any portion of the hedge period remains. Consequently, those triggered assessments may or may not occur when an entity typically assesses hedge effectiveness throughout the year. For example, if an entity typically assesses hedge effectiveness as of each calendar quarter end but identifies that a change in hedged risk has occurred at the end of January, it would have to assess hedge effectiveness as of the end of January to determine whether hedge accounting can continue. Certain private companies and not-for-profit entities applying the timing relief in paragraphs 815-20-25-139 through 25-143 would be permitted to defer that assessment of effectiveness to the date on which the financial statements are available to be issued in accordance with that guidance.

BC55. The amendments in this proposed Update would clarify that an entity needs to test its best estimate of the hedged risk only for the periods in which it was the entity’s best estimate. The date on which an entity identifies that the hedged risk changed would be the relevant date as of which the entity would begin using the revised hedged risk in its prospective hedge effectiveness testing. That date may not necessarily be the date on which the hedged risk actually changed.

BC56. The Board believes that using the identification date would be consistent with the amendments in Update 2017-12 that are related to changing from a qualitative to a quantitative method of assessing hedge effectiveness. On that issue, the Board decided that an entity should apply a quantitative method of assessing hedge effectiveness beginning in the period in which it identifies that a change in facts and circumstances indicates that qualitative assessments no longer are appropriate. Paragraphs BC211–BC214 in the basis for conclusions of that Update explain that the Board decided that it would be inappropriate for an entity to override judgments made in prior periods because applying the qualitative method in those prior periods was deemed appropriate at the time. Similarly, the Board believes that if an entity’s best estimate of the hedged risk in a previous period is later revised, it would be inappropriate to override the judgments made in the previous period. Accordingly, the proposed amendments would clarify that an entity should not override its judgment of the best estimate of the hedged risk made in a previous period by using the revised hedged risk to perform the retrospective hedge effectiveness assessment.

Assessing Shared Risk Exposure for Forecasted Transactions Hedged in a Group

BC57. The amendments in this proposed Update would require forecasted transactions hedged in a group to prospectively share the risk exposure for which they are being hedged at inception and on an ongoing basis. The amendments in Update 2017-12 to the guidance in paragraph 815-20-55-23 removed the requirement that forecasted transactions hedged in a group share the same risk exposure after hedge inception. That requirement was removed to allow an entity to continue hedge accounting if its hedged risk changed from one contractually specified component (in a nonfinancial hedge) or one contractually specified interest rate (in a hedge of interest rate risk) to another and the hedging relationship continued to prospectively test highly effective.

BC58. When the Board removed the requirement for the ongoing assessment of shared risk exposure for transactions hedged in a group, it did not consider entities changing the hedged risk from the variability in a contractually specified component or contractually specified interest rate to the variability in overall cash flows attributable to the forecasted transaction. Because the amendments in paragraph 815-30-55-1P in this proposed Update would allow the hedged risk to change from the variability in a contractually specified component or contractually specified interest rate to the variability in overall price, the Board believes that it is necessary to add the requirement that forecasted transactions hedged in a group share the risk exposure for which they are being hedged. Otherwise, an entity could change its hedged risk after hedge inception from the variability in a contractually specified component or contractually specified interest rate to the variability in overall price and continue hedge accounting, even if the forecasted transactions hedged for changes in overall price do not share the same risk exposure.

BC59. In removing the requirement for the ongoing assessment of shared risk exposure for transactions hedged in a group, the Board did not intend to allow transactions with disparate and potentially offsetting risk exposures to be aggregated together and hedged on a net basis. That offsetting effect could arise in hedges of the variability in overall price as a result of differences in basis differentials above or below a traded commodity index. Forecasted transactions could have different basis differentials as a result of different transportation costs, differing qualities or grades of a commodity, or differences in local supply and demand factors.

BC60. For example, an entity forecasting the purchase of a commodity at different locations may determine that the basis at one location (primarily the result of transportation costs) offsets the basis at another location to the extent that those transactions are not deemed to share the same risk exposure. The amendments in this proposed Update would preclude those forecasted transactions from being aggregated and hedged as a group for changes in overall price after hedge inception, even if the hedge prospectively tests highly effective.

BC61. However, the Board believes that the proposed guidance on shared risk exposure should not limit the application of the guidance on a change in hedged risk. To ensure that the shared risk exposure guidance does not impede entities applying the change in hedged risk guidance for hedges of groups of forecasted transactions, the amendments in paragraph 815-20-55-23 in this proposed Update indicate that if the hedged risk associated with one or more forecasted transactions hedged in a group changes after hedge inception, hedge accounting may continue if the forecasted transactions at the date the change is identified prospectively share the risk exposure for which they are being hedged and all other criteria to apply cash flow hedge accounting continue to be met.

BC62. The group of forecasted transactions yet to occur would not be required to share the same risk exposure with forecasted transactions that have already occurred at the date that the change in hedged risk is identified. That aligns with the amendments in paragraph 815-20-25-79B in this proposed Update that would require the effectiveness assessment to be performed with the revised hedged risk only for periods during which it is an entity's then-best estimate. Because the proposed amendments would require only a prospective assessment of shared risk exposure incorporating the revised hedged risk after a change in hedged risk is identified, an entity would not need to assess whether hedged transactions identified using hindsight share the same risk exposure. That is because hedged transactions identified using hindsight already occurred when the change in hedged risk is identified, those transactions would not be included in a prospective assessment of shared risk exposure.

BC63. The Board believes that if the hedged risks of all forecasted transactions hedged in a group change from one identical contractually specified component or identical contractually specified interest rate (including tenor and reset date) to another, an entity could qualitatively conclude that all forecasted transactions continue to share the same risk exposure. However, if the hedged risk changes from the variability in a contractually specified component or contractually specified interest rate to the variability in overall price risk, an entity may need to perform a more robust correlation analysis to determine whether the forecasted transactions hedged in a group prospectively continue to share the same risk exposure. Because transactions hedged for overall price risk could incorporate different bases (for example, related to transportation costs) that could result in the forecasted transactions not sharing the same risk exposure, an entity may be unable to assume that those transactions hedged in a group share the same risk exposure. Moreover, if some forecasted transactions change to a revised contractually specified risk but others remain at the initially designated contractually specified risk, an entity may need to determine whether forecasted transactions with the revised contractually specified risk and those with the initially designated contractually specified hedged risk share the same risk exposure.

BC64. The amendments in paragraph 815-20-55-23 in this proposed Update also would remove the example that indicates that interest payments hedged in a group need to vary with the same index to qualify for hedging with a single derivative. While forecasted transactions hedged in a group often may vary with the same index, there could be instances in which changes in the cash flows associated with forecasted transactions with different interest rate indexes or commodity indexes are highly correlated. In those instances, forecasted transactions varying with different indexes could be aggregated in a group and hedged with a single derivative that provides a highly effective offset to changes in the overall cash flows of the group. The Board did not intend to prohibit the application of hedge accounting in those situations.

Scope

BC65. The amendments in this proposed Update would exclude hedges of foreign exchange risk and credit risk from the scope of the guidance on a change in hedged risk. Those scope exceptions were not included in the amendments in Update 2017-12. The Board decided to remove hedges of foreign exchange risk from the scope of this proposed Update because of the documentation requirements in current GAAP in paragraph 815-20-25-3(d)(1)(iii)(01) that require that an entity document the exact amount of foreign currency being hedged when designating the forecasted transaction in a hedge of foreign exchange risk. That requirement does not permit the forecasted transaction (that is, the external event involving the transfer of value) to be separated from the hedged risk that creates variability in the cash flows associated with the forecasted transaction (that is, the foreign exchange index). The Board believes that there is no conceptual basis for excluding hedges of foreign exchange risk from the change in hedge risk guidance. However, the Board is concerned that changes to the guidance on foreign exchange documentation and designation could have the unintended consequence of disrupting current foreign exchange hedging strategies.

BC66. The Board believes that changing the currency denomination of the forecasted transaction would be allowed for non-foreign-exchange risk hedges. As demonstrated in the example in paragraph BC18(a) in which the hedged risk changed from EURIBOR to USD LIBOR because interest rate risk, not foreign exchange risk, is being hedged, an entity would be able to change the currency denomination of the hedged risk. In contrast, an entity would not be able to apply the change in hedged risk guidance to hedges of foreign exchange risk. That is, the entity could not designate that it is hedging the variability in a certain currency associated with foreign sales and subsequently change the hedged currency risk associated with those foreign sales.

BC67. The Board decided to remove hedges of credit risk from the scope of the amendments in this proposed Update because it is unaware of a situation in which the change in hedged risk guidance could be applied in the context of credit risk hedging. Because contractually specified credit risks cannot be hedged under current GAAP, an entity would not be in a situation in which it designated a particular contractually specified credit risk as hedged but recorded a missed forecast because a different credit index was ultimately explicitly referenced in documentation supporting the hedged forecasted transaction.

BC68. Moreover, the Board's rationale for proposing that hedges of contractually specified components and contractually specified interest rates be allowed to change to hedges of overall cash flows is to allow the change to overall price risk when a contractually specified interest rate or a contractually specified component expected to be explicitly referenced ultimately is not. Again, because a contractually specified credit risk is unable to be designated as hedged under current GAAP, an entity would not find itself in a similar situation when hedging credit risk. Additionally, if an entity is hedging changes in its own credit spread over a contractually specified interest rate related to a forecasted issuance of debt, the entity would not seek to change the credit risk it was hedging to a risk other than its own. Consequently, the Board believes that there is no conceptual or practical basis for including hedges of credit risk within the scope of the change in hedged risk guidance.

BC69. Because the proposed scope exclusions for hedges of foreign exchange risk and hedges of credit risk were not included in the amendments in Update 2017-12, the Board decided to seek feedback on whether transition guidance is needed for those new exclusions by including a question for respondents on the issue in this proposed Update.

Issue 2: Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions

BC70. On the basis of stakeholders' feedback since the issuance of Update 2017-12, the Board decided that it would supersede paragraphs 815-20-25-22A through 25-22B and the implementation guidance in paragraph 815-20-55-26A and replace it with the proposed guidance in paragraph 815-20-25-15B and paragraphs 815-20-25-22C through 25-22E. The Board believes that the proposed guidance would better reflect its original intent in Update 2017-12 on contractually specified component risk hedging.

Nature of Documentation That May Evidence a Contractually Specified Component

BC71. The Board proposes adding paragraph 815-20-25-22C to clarify the nature of the documentation that may evidence a contractually specified component.

BC72. After issuance of Update 2017-12, stakeholders asked whether documents explicitly referencing a contractually specified component must be legally binding on one or both parties. They also asked when the documentation must be obtained to qualify for cash flow hedge accounting.

BC73. When the Board decided to allow an entity to designate the variability in a contractually specified component as the hedged risk in deliberations on Update 2017-12, it intended for the entity to evidence that the price component designated as hedged is part of the total price of the nonfinancial asset and exposes the entity to the risk of price variability. Consistent with that intent, the Board believes that it is not the type of contract, agreement, or documentation that is important but rather that the contractually specified component is *explicitly referenced* in documentation that supports the price at which a nonfinancial asset is purchased or sold. This explicitly referenced concept is a central part of the Master Glossary term *contractually specified component*. In the amendments in Update 2017-12, the Board decided to use the term *agreement* rather than the term *contract* in the definition of *contractually specified component* because it did not intend for the documentation evidencing the contractually specified component to have to be legally binding.

BC74. The amendments in paragraph 815-20-25-22C in this proposed Update reference the term *agreement* in the definition to emphasize the concept that acceptable documentation for evidencing a contractually specified component is broader than a legal contract binding on one or both parties. The Board also decided to provide examples of the types of documentation in which a contractually specified component may be explicitly referenced. However, the Board notes that the list is not all-inclusive and it did not want to preclude contractually specified components in other types of documentation from satisfying the explicitly referenced criterion.

BC75. The Board decided to include spot transaction receipts as an example of potential documentation that an entity could use to evidence a contractually specified component. The Board learned from stakeholders that an explicitly referenced contractually specified component may be available on a spot transaction receipt or confirmation only in certain industries. The Board understands that spot transactions in certain industries may not explicitly reference a contractually specified component because of marketplace norms specific to those industries. However, the Board did not intend for that to be a limiting factor to achieving contractually specified component risk hedging in industries in which contractually specified components are explicitly referenced on spot transaction receipts.

BC76. The Board also decided to clarify that whether the documentation that includes the explicitly referenced contractually specified component is received before or after the transaction occurs, that timing should not be an impediment to designating the variability in a contractually specified component as the hedged risk in a not-yet-existing contract. Instead, the focus of the guidance is on an entity’s expectation at hedge designation that the contractually specified component will be explicitly referenced.

Hedging a Contractually Specified Component in a Not-Yet-Existing Agreement

BC77. Paragraph 815-20-25-22D would carry forward the guidance in paragraph 815-20-25-22B that an entity may designate as the hedged risk the variability in a contractually specified component that is not yet explicitly referenced if the entity expects that it will receive documentation that will satisfy that requirement. The amendments in this proposed Update would clarify that an entity may rely on its prior experience or another reasonable basis in determining whether an agreement will include an explicitly referenced contractually specified component when designating the hedging relationship. That is, an entity that frequently enters into the same type of agreement with the same suppliers or has experience with certain types of transactions would be able to base the expectation that a contractually specified component will be explicitly referenced on that prior experience.

BC78. The amendments in this proposed Update also would remove the wording in paragraph 815-20-25-22B that indicates that in a hedge of a not-yet-existing contract an entity needs to determine whether the variability in cash flows attributable to the change in the contractually specified component *can continue to be designated as the hedged risk* once an agreement is entered into. Stakeholders noted that this wording may preclude hedges of spot transactions and agreements in which the price becomes fixed when entered into because the cash flow variability of a contractually specified component ceases when those agreements are entered into. The Board did not intend to preclude contractually specified components to be hedged in those types of arrangements if all requirements for cash flow hedging and contractually specified risk hedging are met. Thus, the Board decided to remove the language that could be interpreted as prohibiting those transactions from qualifying for contractually specified component risk hedging.

Hedging a Contractually Specified Component in an Existing Agreement

BC79. Stakeholders asked the Board to clarify how the criteria in paragraph 815-20-25-22A for designating a contractually specified component in an existing document should be applied when the agreement to purchase or sell a nonfinancial asset neither is a derivative in its entirety nor contains an embedded derivative. For example, stakeholders asked which criteria, if any, apply to designating a contractually specified component evidenced by a spot purchase receipt, which neither is a derivative in its entirety nor contains an embedded derivative. To clarify the Board’s intent in those situations, the Board decided that it would replace the guidance in paragraph 815-20-25-22A with the proposed amendments in paragraph 815-20-25-22E.

BC80. Paragraph 815-20-25-22E(a) would replace paragraph 815-20-25-22A(a) and reinforce the principle that the transaction would have to meet the requirements in paragraph 815-20-25-15 and proposed paragraph 815-20-25-15B (described in paragraphs BC86–BC94) to be eligible for designation as a hedged forecasted transaction.

BC81. Paragraph 815-20-25-22E(b) would clarify that an entity would not need to apply the normal purchases and normal sales scope exception to agreements that qualify as hedged forecasted transactions in accordance with paragraph 815-20-25-22E(a). In those cases, an entity would be required to determine only that all underlyings in the agreement are clearly and closely related to the asset being sold or purchased. That is, for an agreement that is eligible to be designated as a hedged forecasted transaction in accordance with paragraph 815-20-25-22E(a), an entity would apply the *clearly and closely related underlying* aspect of the normal purchases and normal sales scope exception to determine whether it can hedge an explicitly referenced contractually specified component.

BC82. For example, if the price of wheat in an agreement referenced a wheat index and a gold index (and the gold index is not bifurcated as an embedded derivative), the entire agreement would be ineligible for contractually specified component risk hedging. Under the contractually specified component model for nonfinancial assets, hedge effectiveness testing is isolated to the contractually specified component to determine whether all changes in fair value of the hedging instrument may be deferred in accumulated other comprehensive income during the hedging relationship. Accordingly, the Board believes that it is important that no other unrelated price component counteract an entity's exposure to cash flow variability arising from the designated contractually specified component. As a result, the Board decided to eliminate the eligibility of contracts with potentially speculative features from contractually specified component risk hedging. The Board believes that applying the *clearly and closely related underlying* guidance as part of the overall proposed guidance in paragraph 815-20-25-22E would achieve its intended result and also believes that guidance is well understood in practice and could be applied in a cost-effective manner.

BC83. Paragraph 815-20-25-22E(c) through (d) would clarify that the pricing formula that includes the contractually specified component should determine the price of the nonfinancial asset. This is one of the basic concepts of contractually specified component risk hedging discussed in deliberations leading to the issuance of Update 2017-12. That concept refutes the presumption under previous GAAP that a component or ingredient of a nonfinancial hedged item generally does not have a predictable and separately measurable effect on the price of the nonfinancial item that is comparable to the effect of a change in interest rates on the price of a bond. Therefore, under current GAAP if the pricing formula does not determine the price of the nonfinancial asset, a change in the value of a contractually specified component may not have a direct and measurable effect on the change in total price of the nonfinancial asset.

BC84. The Board decided to split the criteria in paragraph 815-20-25-22E(c) through (d) between spot-market transactions and non-spot-market transactions. Some stakeholders expressed a concern that even though a pricing formula that is written on a spot receipt may determine the price of the nonfinancial asset, that pricing formula could be altered such that the pricing does not align with how the nonfinancial asset is priced in its spot market. The Board believes that the pricing formula on the spot receipt and the spot-market pricing should align. This is much less of a concern for non-spot-market transactions because any agreement generally would be negotiated between the buyer and the seller at market terms prior to the transaction occurring.

BC85. For non-spot-market transactions, the Board believes that an entity's assessment of a pricing formula would vary on the basis of facts and circumstances. For example, the assessment of a pricing formula that is explicitly referenced in documentation before the forecasted transaction occurs may require less analysis than a pricing formula that is explicitly referenced in documentation that is obtained after the transaction has occurred. An entity that has prior experience with similar pricing formulas for similar transactions would use that past experience as part of its assessment, and a more detailed analysis may be appropriate when the entity does not have that prior experience (for example, when it enters into a new line of business).

Hedging the Forecasted Purchase or Sale of a Nonfinancial Asset Accounted for as a Derivative

BC86. During outreach on the contractually specified component issues previously discussed, stakeholders informed the Board of the diversity in practice about whether a forecasted transaction for the purchase or sale of a nonfinancial asset that is in a contract accounted for as a derivative under Topic 815 qualifies for hedge accounting. The Board proposes adding paragraph 815-20-25-15B to clarify the guidance in paragraph 815-20-25-15(d) through (e) on eligible forecasted transactions in a cash flow hedge of a forecasted purchase or sale of a nonfinancial asset and, thus, resolve the diversity in practice. The amendments in this proposed Update would clarify that a future purchase or sale of a nonfinancial asset through a contract that is accounted for as a derivative under Topic 815 may be designated as the forecasted transaction in a cash flow hedge if the following two criteria are met:

a. Physical settlement of the contract accounted for as a derivative is probable in accordance with paragraph 815-20-25-15(b).
b. The forecasted transaction is not the acquisition of a nonfinancial asset that subsequently will be remeasured with changes in fair value attributable to the hedged risk reported currently in earnings.

BC87. Forecasted transactions of nonfinancial assets meeting the above criteria could be hedged for any qualifying risk (that is, variability in overall price, a contractually specified component, or a foreign exchange rate). The amendments in this proposed Update would clarify that after hedge inception, if an entity assesses that physical settlement of the contract accounted for as a derivative is not probable, it should apply the missed forecast guidance in paragraphs 815-30-40-4 through 40-6.

BC88. Some stakeholders interpret the guidance in paragraph 815-20-25-15(d) through (e) to allow the purchase or sale of a nonfinancial asset that is in a contract accounted for as a derivative under Topic 815 to qualify as a forecasted transaction, provided that physical settlement of that contract is probable and all other criteria for cash flow hedge accounting are satisfied. Those stakeholders maintain that an entity is not hedging the variability associated with the derivative gain or loss but rather the variability of the price risk associated with the forecasted purchase or sale of the nonfinancial asset that is recognized upon physical settlement.

BC89. That interpretation may be analogized to an all-in-one hedge. In an all-in-one hedge, a fixed-price contract to purchase or sell an asset accounted for as a derivative under Topic 815 can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the forecasted transaction that will occur upon gross settlement of the derivative instrument itself if the contract will involve gross settlement.

BC90. Other stakeholders stated that such an analogy to an all-in-one hedge is inappropriate because the all-in-one hedge guidance applies to a narrow fact pattern. Those stakeholders maintain that an entity cannot ignore the fact that the contract that gives rise to the purchase or sale may be accounted for as a derivative and, therefore, is not permitted to be an eligible hedged item under paragraph 815-20-25-15(e) unless the normal purchases and normal sales scope exception in Topic 815 is applied.

BC91. The Board believes that a purchase or sale of nonfinancial assets that meets the criteria in the amendments in paragraph 815-20-25-15B in this proposed Update should not be disqualified from being designated as forecasted transactions by either paragraph 815-20-25-15(d) or (e). Specifically, the Board believes that the requirement in paragraph 815-20-25-15(d), from a nonfinancial hedging perspective, is meant to prevent hedging nonfinancial assets acquired for trading purposes that are subsequently remeasured at fair value through earnings. The forecasted transactions that would qualify for cash flow hedging under the proposed amendments in paragraph 815-20-25-15B would not be those types of transactions. For example, a forecasted purchase of a commodity by an entity that is within the scope of Topic 940, Financial Services—Brokers and Dealers, would not qualify.

BC92. In addition, the Board believes that the requirement in paragraph 815-20-25-15(e) is meant to prevent hedging variable cash flows attributable to an asset or liability that is currently being remeasured at fair value through earnings, such as the periodic cash flows attributable to a variable rate bond that is being accounted for under the fair value option. In those cases, variable cash flows are directly related to the instrument being remeasured at fair value through earnings.

BC93. The Board believes that there is no such relationship between the cash flows associated with the forecasted purchase or sale of a nonfinancial asset and the associated forward contract accounted for as a derivative that will physically settle. To illustrate, when a forward contract to purchase wheat is physically settled, the wheat is initially measured and recognized on the balance sheet at the spot market price, which is the same regardless of whether the purchase was consummated through the settlement of the derivative. Accordingly, in those circumstances, the Board believes that the cash flows associated with the forecasted purchase or sale of the nonfinancial asset do not relate to the forward contract accounted for as a derivative. For those transactions, the Board believes that the contract accounted for as a derivative is merely the mechanism through which the forecasted transactions are consummated. Therefore, the Board believes that the amendments in this proposed Update would aim to reduce diversity in practice and would align with its original intent in Update 2017-12 to more closely align hedge accounting with an entity's risk management activities.

BC94. However, the Board observes that the amendments in paragraph 815-20-25-15B in this proposed Update would not apply to hedging groups of forecasted purchases and sales contracts referred to as *bookouts*. Bookouts allow a counterparty to close out an open position in a derivative or cancel a contract through cash settlement of the fair value of the contract on the date of cancellation. Those contracts are common in the energy industry. Because the gross settlement requirement of the normal purchases and normal sales scope exception is not met, an entity is not able to apply that scope exception and the contracts must be accounted for as derivatives. Because it is often not known which specific contracts will physically settle, an entity would be required to designate multiple purchases and sales contracts to create a pool of contracts and assert that physical settlement is probable across the portfolio for hedge accounting to be operable. The Board notes that this fact pattern is similar to that of hedging a net position, which is not permitted in fair value or cash flow hedging. Additionally, if the contract accounted for as a derivative does not physically settle, an entity would have obtained hedge accounting for a derivative contract that settled net or in cash, which also is not permitted under GAAP. Therefore, the Board believes that the guidance in paragraph 815-20-25-15B would be limited to contracts accounted for as derivatives that physically settle.

Issue 3: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

BC95. The amendments in Update 2017-12 eliminated the separate measurement and recognition of ineffectiveness for net investment hedges and required that amounts included in the assessment of effectiveness be recorded in accumulated other comprehensive income until the foreign entity is substantially liquidated. As a result, for a foreign-currency-denominated debt instrument that is designated as the hedging instrument in a net investment hedge and designated as the hedged item in a fair value hedge of interest rate risk (that is, a dual hedge), the gain or loss on the remeasurement of the fair value hedge basis adjustment at the spot exchange rate must be deferred in accumulated other comprehensive income.

BC96. Before the issuance of Update 2017-12, that foreign exchange remeasurement was recognized in current-period earnings because it was a source of ineffectiveness resulting from the notional mismatch in the net investment hedge. The foreign exchange remeasurement of the fair value hedge basis adjustment was offset in earnings by the foreign exchange remeasurement of the derivative designated as the hedging instrument in the fair value hedge of interest rate risk. That resulting offset no longer exists under the amendments in Update 2017-12.

BC97. To resolve that issue, the Board decided that the fair value hedge basis adjustment would be excluded from the assessment of the effectiveness of the net investment hedge when the debt instrument also is designated as the hedged item in a fair value hedge of interest rate risk. Accordingly, the notional amount of the debt instrument that is designated as the hedging instrument in the net investment hedge would not change over time as a result of applying fair value hedge accounting. Therefore, the notional amount for the debt instrument may continue to match the notional amount of the investment in a foreign subsidiary that is designated in the net investment hedge. Because the debt instrument's fair value hedge basis adjustment would be excluded from the assessment of effectiveness of the net investment hedge, the remeasurement for changes in the spot rates on the fair value hedge basis adjustment would be recognized in earnings in accordance with Subtopic 830-20, Foreign Currency Matters—Foreign Currency Transactions.

BC98. The Board did not intend to cause amounts previously recorded as ineffectiveness from the fair value hedge basis adjustment to be recognized in accumulated other comprehensive income for a net investment hedge when the debt instrument also is designated as the hedged item in a fair value hedge of interest rate risk. Accordingly, the amendments in this proposed Update would require that an entity exclude the fair value hedge basis adjustment from the assessment of hedge effectiveness in a net investment hedge when the hedging instrument also is a hedged item in a fair value hedge of interest rate risk.

BC99. The amendments in this proposed Update would be applied only to foreign-currency-denominated debt instruments that are both a hedging instrument and a hedged item and should not be applied by analogy to other circumstances. Accordingly, if the fair value hedge for interest rate risk is subsequently discontinued, an entity would consider the debt instrument's fair value hedge basis adjustment when prospectively assessing the effectiveness of the net investment hedge.

Issue 4: Using the Term *Prepayable* under the Shortcut Method

BC100. Financial assets and liabilities considered *prepayable* for the purposes of the guidance added in Update 2017-12 may be different from the financial assets and liabilities considered *prepayable* for the purposes of applying the shortcut method for assessing hedge effectiveness. To avoid potential confusion, the Board decided to amend the shortcut method guidance by replacing the terms *prepayable* or *prepayment* with *early settlement* and replacing the term *prepaid* with *settled early*. No transition guidance is needed because those proposed amendments would not change the guidance for applying the shortcut method.

Effective Date and Transition

Effective Date

BC101. The Board decided that the amendments in this proposed Update would be effective for all entities for fiscal years beginning after December 15, 2020. For public business entities, the proposed amendments would be effective for interim periods within fiscal years beginning after December 15, 2020. For all other entities, the proposed amendments would be effective for interim periods within fiscal years beginning after December 15, 2021. Early adoption would be permitted for all entities on any date on or after issuance of a final Update of these proposed amendments if the entity has adopted the amendments in Update 2017-12.

BC102. The Board decided to align the effective date for the application of the proposed Update to annual fiscal years for public business entities and all other entities.

BC103. While the application of the Private Company Decision-Making Framework typically results in a one-year delay in the effective dates for public business entities and all other entities, the Board wanted to align the annual effective dates of this proposed Update for public and nonpublic business entities because the amendments in this proposed Update are meant to clarify or otherwise improve the guidance in Update 2017-12. Moreover, because of the relatively limited nature of the amendments in this proposed Update, the Board believes that nonpublic business entities would be able to implement the proposed amendments on the same timeline as public business entities for annual periods.

Transition Provisions

BC104. For entities that adopt the amendments in this proposed Update at the same time that they adopt the amendments in Update 2017-12, the transition method for both Updates would be the same, in accordance with paragraph 815-20-65-6(g). For example, the transition provisions in Update in 2017-12 related to contractually specified component hedging would apply to the amendments related to contractually specified component hedging in this proposed Update.

BC105. For entities that have adopted the amendments in Update 2017-12 before the issuance of a final Update of these proposed amendments, the Board decided that it would provide entities with the flexibility to apply all of the proposed amendments either retrospectively to the date of adoption of the amendments in Update 2017-12 or prospectively from the date of adoption of a final Update of these proposed amendments with the exception of the proposed amendments related to dual hedges.

BC106. The amendments in paragraph 815-20-65-6(d)(5) in this proposed Update would allow retrospective designation of certain new hedging relationships between the date of adoption of Update 2017-12 and the adoption date of a final Update of these proposed amendments for hedging instruments, hedged items, or forecasted transactions that existed between those two dates if all other requirements for hedge accounting are met. The retrospective designation of new hedging relationships would apply only to the proposed amendments in paragraph 815-20-25-15B, paragraphs 815-20-25-22C through 25-22E, and paragraph 815-20-55-38. Those proposed paragraphs relate to hedging a forecasted purchase or sale of a nonfinancial asset accounted for as a derivative if it is probable that the contract will be physically settled and not subsequently be remeasured with changes in fair value attributable to the hedged risk reported currently in earnings, designating as the hedged risk the variability in a contractually specified component, and strategies in which a foreign-currency-denominated debt instrument is both a hedging instrument in a net investment hedge and the hedged item in a fair value hedge.

BC107. For example, an entity may have issued a foreign-currency-denominated debt instrument after it had adopted the amendments in Update 2017-12 that it would have designated as both a hedging instrument and hedged item in accordance with paragraph 815-20-55-38 but elected not to because of the financial statement mismatch resulting from the amendments in Update 2017-12. Under the proposed amendments in paragraph 815-20-65-6(d)(5), an entity would be able to retrospectively designate and reflect the debt instrument in a dual hedging relationship.

BC108. The Board believes that retrospective designation of new hedging relationships in those limited circumstances would allow all entities to apply the strategies that were intended to be allowed by the amendments in Update 2017-12 from the date of adoption of the amendments in Update 2017-12.

Issue 1: Change in Hedged Risk in a Cash Flow Hedge

BC109. All entities, regardless of the transition method, would be required to amend their hedge documentation at the date of adoption of a final Update of these proposed amendments for existing hedges to include the method to be used to identify a hedged transaction using hindsight. Documenting a hindsight identification method at hedge inception is a new requirement in Topic 815 and not a clarification of an existing amendment in Update 2017-12. Thus, the Board believes that relief from the guidance that requires dedesignation when hedge documentation is amended is necessary to facilitate the adoption of the amendments in this proposed Update while retaining an accurate representation of the economics of an entity’s risk management activities.

BC110. The Board decided that it would provide entities that elect retrospective application with the choice to apply the amendments in this proposed Update related to the change in hedged risk guidance to avoid a missed forecast retrospectively as of the date of adoption of the amendments in Update 2017-12. If an entity had a missed forecast since adopting the amendments in Update 2017-12 that would have been avoided if the proposed amendments were applied at that time, retrospective adoption would essentially restore the financial statements to what would have been presented if these proposed amendments had been effective at the time the missed forecast was recognized. The proposed amendments also would eliminate the tainting effect of that missed forecast. Because it was the Board’s intent for entities to avoid those missed forecasts with the adoption of the amendments in Update 2017-12, the Board believes that it is appropriate to provide entities with the option to retrospectively adopt the proposed amendments that clarify the change in hedged risk guidance as of the date they adopted the amendments in Update 2017-12. Entities that do not elect retrospective application would prospectively reflect the proposed amendments to the change in hedged risk guidance as of the date of adoption of a final Update of these proposed amendments.

BC111. The Board also decided to allow entities to rebalance hedges affected by the proposed amendments to the prospective effectiveness assessment guidance for cash flow hedges within the scope of the change in hedged risk guidance by adjusting the notional amount of the hedging instrument. Because the Board did not intend for the adoption of the amendments in this proposed Update to result in entities that were incorporating all potential hedged risks in their prospective assessments of hedge effectiveness to have less effective hedges, the proposed amendments would allow rebalancing of affected hedges. The option to rebalance cash flow hedge existing at the date of adoption of the amendments in this proposed Update would not be available to an entity that was already incorporating only its best estimate of the hedged risk in its prospective assessment of hedge effectiveness.

BC112. The Board believes that if an entity elects to rebalance hedging relationships existing at the date of adoption of the amendments in this proposed Update affected by the proposed amendments to the assessment of hedge effectiveness, the entity should apply the adjustments on a retrospective basis to the date of initial application of Update 2017-12. Consequently, if the hedge existed as of the date of adoption of Update 2017-12, opening balance sheet retained earnings should be adjusted to reflect the effect of rebalancing as of the date of initial application of Update 2017-12. The Board believes that retrospective application of the proposed rebalancing amendments to the date of initial application of Update 2017-12 is appropriate to reflect the interest rate or commodity price environment existing as of the date of initial application of the amendments in Update 2017-12 or the date that the affected hedge was designated thereafter.

Issue 2: Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions

BC113. The Board decided that it would allow entities that elected retrospective adoption the choice to apply the amendments in this proposed Update related to contractually specified component hedging retrospectively as of the date of adoption of the amendments in Update 2017-12 or prospectively as of the adoption date of a final Update of these proposed amendments. If the clarification provided by the proposed amendments in paragraphs 815-20-25-22C through 25-22E would have allowed an entity to designate as the hedged risk a contractually specified component in a hedge of forecasted purchase or sale of a nonfinancial asset since it adopted the amendments in Update 2017-12, the Board believes that an entity should be able to retrospectively reflect that contractually specified component risk hedge for hedges existing at the date of adoption of Update 2017-12 and hedges designated between the date of adoption of the amendments in Update 2017-12 and the adoption date of a final Update of these proposed amendments.

BC114. If an entity’s hedge of changes in overall cash flows was highly effective since inception and the entity is able to apply the transition provisions of Update 2017-12 by designating the variability in a contractually specified component as the hedged risk as of the adoption date of that Update, there would be no retrospective adjustment to prior-period financial statements upon adoption of the amendments in this proposed Update. That is because the separate recognition and presentation of ineffectiveness were eliminated in the amendments in Update

2017-12. However, if an entity's hedge of changes in overall cash flows as originally designated became not highly effective after its adoption of the amendments in Update 2017-12, the entity would retrospectively adjust its financial statements to reflect that hedge accounting was maintained because the hedging relationship would have qualified for contractually specified component risk hedging in accordance with these proposed amendments.

BC115. If an entity that elects retrospective adoption does not wish to retrospectively adopt the proposed amendments in paragraphs 815-20-25-22C through 25-22E, it would be able to adopt them prospectively such that the amendments in this proposed Update would affect only existing hedges at adoption of a final Update of these proposed amendments and new hedges in periods beginning after adoption of a final Update of these proposed amendments. The amendment of hedge documentation to revise the hedged risk from changes in overall cash flows to changes in a contractually specified component would not result in automatic dedesignation. The Board believes that automatic dedesignation would deter an entity from changing to contractually specified component risk hedging, which is not the Board's intent.

BC116. The Board believes that the retrospective application of the proposed amendments related to contractually specified component risk hedging in paragraph 815-20-25-15B and paragraphs 815-20-25-22C through 25-22E and the retrospective application of the proposed change in hedged risk guidance in accordance with paragraph 815-20-65-6(d)(1) and (2) should be as of the date of adoption of the amendments in Update 2017-12 rather than the date of initial application of the amendments in Update 2017-12.

BC117. Those dates do not differ if an entity adopted Update 2017-12 at the beginning of a fiscal year. If an entity adopted those amendments in an interim period, for example, at the beginning of an entity's fourth quarter, the date of adoption of Update 2017-12 is the beginning of the entity's fourth quarter. However, in accordance with paragraph 815-20-65-3, the entity had to adjust prior reporting periods for existing hedges as of the date of adoption of Update 2017-12 back to the beginning of its fiscal year (the date of initial application of Update 2017-12). In applying a final Update of these proposed amendments retrospectively, the Board believes that those proposed amendments should be applied to the date of adoption of Update 2017-12 because the proposed amendments relate to hedge accounting strategies or documentation relief that was added or amended by Update 2017-12. Entities should not be allowed to apply those new strategies before the date of adoption of Update 2017-12.

Issue 3: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

BC118. The proposed transition guidance in paragraph 815-20-65-6(c)(1) relates to dual hedges. That guidance indicates that an entity would be required to reverse the amount reclassified from retained earnings to accumulated other comprehensive income upon initial adoption of Update 2017-12 related to the foreign exchange remeasurement of the fair value hedge basis adjustment in the net investment hedge as of the date of initial application of Update 2017-12. For dual hedges existing as of the date of adoption of Update 2017-12 or designated between the adoption date of Update 2017-12 and the adoption date of the amendments in this proposed Update, an entity would be required to reclassify the remeasurement of the foreign-currency-denominated debt instrument's fair value hedge basis adjustment that was recognized in other comprehensive income after the initial application date of Update 2017-12 to earnings in the corresponding period or periods in which it was recognized in other comprehensive income. An entity would not dedesignate the hedging relationships to apply those transition provisions.

BC119. The Board decided that it would require retrospective application of those amendments to the date of initial application of the amendments in Update 2017-12 because the Board did not intend to cause the financial statement presentation mismatch that resulted from the adoption of the amendments in Update 2017-12. If retrospective application was not required, the presentation of the dual hedging strategy before the initial application date of the amendments in Update 2017-12 would reflect the economic offset of the foreign exchange remeasurement of the interest rate swap and fair value hedge basis adjustment in earnings, but that economic offset would not be reflected after the initial application date of Update 2017-12. The Board believes that result would be inappropriate because the economics of dual hedging relationships did not change with the adoption of the amendments in Update 2017-12. Thus, the Board believes that entities should be required to retrospectively apply these proposed amendments applicable to dual hedging relationships to appropriately represent the risk mitigation achieved by those strategies.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed improvements to the Taxonomy through Proposed Taxonomy Improvements provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the Taxonomy will be finalized as part of the annual release process.