The Association of Accountants and Financial Professionals in Business

January 13, 2020

Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 2019-790, Proposed Accounting Standards Update - *Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting*

Dear Mr. Kuhaneck:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update - *Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting* (Proposed Update).

The IMA is a global association representing over 140,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The FRC includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

The FRC appreciates the Board's continued effort to improve the hedge accounting model with the specific objective of improving the financial reporting of hedge relationships to better portray the economic results of an entity's risk management activities. The FRC has identified certain targeted improvements that we believe will further enhance the Proposed Update to ensure its operability and that its objective is met.

Change in Hedge Risk in a Cash Flow Hedge

The FRC believes that the level at which a hedge risk may be designated by an entity could be clearer. Based on our understanding of the examples provided, we agree with the Board's objective of allowing for highly effective hedge relationships to continue if only designated hedged risks change. However, we believe the proposed amendments have created a more complex model for addressing these scenarios, which may reduce the practicality and operability of the intended guidance. Specifically, additional clarification and examples may be needed to apply this guidance to scenarios such as portfolio hedges and multiple hedge relationships, where facts and circumstances may be more complex.

For example, in a hedge of interest rate risk, the amendments in paragraph ASC 815-30-55-1N state that the tenor of an interest rate index is considered an attribute of the hedged risk. Additionally, the Board reemphasizes this point within paragraph BC12 which states that interest rate tenor should be considered part of the hedged risk and has provided Example 25 to evidence this point. However, the FRC notes that the

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language in paragraph BC25 would indicate that a hedged risk could be more broadly designated such that all tenors of a specific index may be designated. This designation however would still need to be assessed in accordance with effectiveness requirements provided in paragraph ASC 815-20-25-79B and the shared risk requirements provided in paragraph ASC 815-20-55-23.

If the hedged risk can be more broadly designated, we would encourage the Board to consider incorporating this ability into the codification. Clarification would be needed to address the effort and operability concerns of entities in relation to considering “all reasonably possible changes in cash flows attributable to the designated hedged risk” and how this requirement interacts with assessing effectiveness using a best estimate.

As it pertains to portfolio hedges broadly, the FRC is aware that currently acceptable practices for testing hedge effectiveness may be disrupted. Specifically, some financial services entities, currently utilize a “worst case” hypothetical derivative for testing effectiveness since the measurement of ineffectiveness is no longer required upon adoption of paragraph ASU 2017-12. For example, if a portfolio of loans which is predominantly comprised of contracts with a one month tenor rate and only some contracts with a three month tenor rate and a derivative with a one month tenor are designated in a hedge relationship, the entity’s effectiveness testing would assume a hypothetical derivative with a three month tenor representing the least effective scenario. The FRC would encourage the Board to ensure that the language used for requiring a best estimate of the hedged risk is not overly prescriptive such that today’s practice for assessing effectiveness of portfolio hedges is preserved.

In addition to effectiveness, clarification is also needed regarding the Board’s intention of requiring forecasted transactions in a portfolio hedge to share the same risk exposure and the amount of effort expected by an entity. As discussed in paragraph BC63, the Board states that a more robust correlation analysis may be required in instances when the hedged risk changes from a contractually specified component/rate to the variability in overall price risk. The Board also indicates in paragraph BC63 that the shared risk assessment may be performed qualitatively for transactions that change from one identical contractually specified rate (including tenor and reset date) to another. Consistent with previous comments, the FRC believes additional clarification in the actual codification may be needed to ensure consistent application in practice. The FRC believes that it is currently unclear what level of analysis is needed in more frequent scenarios where a group of forecasted transactions may vary between tenor, calculation methodology, and index. Paragraph BC64 indicates that the ability to hedge this type of scenario is allowed and seems to imply that passing effectiveness validates the assumption of sharing the same risk. The FRC is supportive of this threshold given the high correlation observed in domestic rates. Any incremental correlation analysis would only increase the amount of effort needed to apply hedge accounting while providing information that is already obtained through an entity’s assessment of hedge effectiveness.

Another complexity introduced by the Proposed Update occurs when multiple hedges are outstanding for the same forecasted transaction. The FRC would be supportive of the Board incorporating in Example 26 a scenario where multiple hedges are designated for the same underlying transaction but with different designated hedged risks. If Entity A had, in addition to the current hedge relationship, also entered into a separate relationship to hedge an additional 500 metric tons of cocoa beans indexed to DEF, it is not clear whether the purchases of cocoa beans indexed to DEF occurring in March 20X1 may be attributed to the DEF designated hedge relationship, and if the purchases of cocoa beans indexed to ABC occurring in April 20X1 should be attributed to the ABC designated hedge relationship. In this scenario, the FRC believes Entity A should first look to the DEF indexed purchases when identifying forecasted transactions for the hedge relationship initially documented as hedging 500 metric tons of cocoa beans indexed to DEF.

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Lastly, the FRC notes that the Board specifically excludes foreign exchange risk from the scope of the change in hedge risk guidance. The FRC understands the difficulty in how a hedge of foreign exchange risk would need to be documented in order to sufficiently separate the forecasted transaction from the designated hedge risk. While potentially easier for financial items, the FRC would encourage the Board to explore the feasibility of including financial instruments and nonfinancial items into the scope of the change in hedged risk guidance. One example would be when entities are expecting to issue or purchase debt in one global market but subsequently change to another market. In this scenario, the FRC believes that documentation of the forecasted transaction based on the functional currency amount of the expected issuance or purchase event could be a feasible solution.

Contractually Specified Components in Cash Flow Hedges of Nonfinancial Forecasted Transactions

The FRC is supportive of the additional guidance applicable to identifying the types of documentation that may be suitable to evidence a contractually specified component. While clear that an entity may obtain documentation after the fact with the hedge designation supported by an entity's experience, it is not clear how an entity should account for the scenario where the expected component was not contractually specified after the fact. The FRC believes this clarification is needed to ensure consistent application across entities.

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

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Institute of Management Accountants
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