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January 13, 2020

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

File Reference No. 2019-790
Re: Proposed Accounting Standards Update, *Codification Improvements to Hedge Accounting*

Dear Mr. Kuhaneck:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Codification Improvements to Hedge Accounting*.

We support the Board's efforts to clarify certain aspects of ASC 815, as amended, and to address implementation issues that have arisen as a result of recent amendments. We also understand the Board's objective of simplifying the hedge accounting guidance and aligning financial reporting with entities' risk management strategies.

We generally agree with the Board that an entity should not be required to dedesignate a cash flow hedging relationship and recognize a missed forecast if (1) the hedged risk changes from the hedged risk designated at hedge inception, (2) the forecasted transaction remains probable, and (3) the hedge remains highly effective prospectively (and would have been highly effective retrospectively). Furthermore, we support the Board's efforts to provide implementation guidance related to cash flow hedges of contractually specified components.

However, we believe that the Board should further refine certain aspects of its proposed accounting model to ensure that the model (1) does not add significant operational complexity to hedge accounting, (2) is consistent with long-standing principles that have been embedded in the hedge accounting model since the issuance of Statement 133,[1] and (3) avoids unintended consequences. For example, we do not believe that the change-in-hedged-risk guidance should allow an entity to apply hedge accounting to a hedging relationship that never would have

[1] FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (superseded).

qualified as highly effective had the revised hedge risk been known at hedge inception. Furthermore, an entity's designation of a contractually specified component as the hedged item should be supported by evidence of a binding agreement.

Also, as noted in more detail in the appendix below, we believe that certain aspects of the proposed guidance are inconsistent with the related implementation guidance and examples. We also observe that an entity' s application of certain provisions could result in unintended consequences (e.g., enable application of the shortcut method to certain hedging relationships in a manner possibly not contemplated by the Board, or require the entity to assess whether a market convention exists to support its designation of a hedge of a contractually specified component).

We understand the Board's desire to respond to constituent concerns in a timely manner; however, because of the volume and complexity of the guidance in ASC 815 and the extent to which the proposed amendments will affect the hedge accounting model, we encourage the Board to perform extensive outreach to constituents after it considers respondent comments to ensure that (1) the final improvements are not so complex that practitioners are unable to apply them; (2) ASC 815, as amended, including the implementation guidance and examples, is internally consistent; and (3) all of the core principles that have historically been a foundation of hedge accounting are retained. Although we do not believe that certain aspects of the model, as proposed, will satisfy these objectives, we do believe that if the Board continues to work with constituents, it will be able to identify alternative solutions that will be consistent with most, if not all, of these objectives as well as the Board's stated objectives for undertaking the improvements project.

The appendix below contains our responses to the proposed ASU's questions for respondents.

We would be happy to share additional perspectives and suggestions with the Board and FASB staff on the matters discussed in our comment letter.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Jon Howard at (203) 761-3235, Ashley Carpenter at (203) 761-3197, or Mark Bolton at (203) 761-3171.

Yours truly,

Deloitte & Touche LLP
cc: Robert Uhl

Appendix

Deloitte & Touche LLP

Responses to Proposed ASU's Questions for Respondents

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?

We have addressed Questions 1–3 together given how these issues seem to be interrelated.

Issue 1: Amendments Related to Changes in the Hedged Risk in a Cash Flow Hedge

We understand that the Board hopes to reduce the frequency of missed forecasts by clarifying that (1) the forecasted transaction and hedged risk are distinct and (2) a change in hedged risk would not be relevant to the determination of whether a forecasted transaction has been missed. However, we believe that certain provisions of the proposed ASU that were added to facilitate this accounting treatment may be too broad and create operational complexity, and that application of these provisions could create a change-in-hedged risk accounting model that is inconsistent with other areas of ASC 815.

<u>Hedge Documentation Issues</u>

Method for Identifying a Hedged Transaction With an Undocumented Hedged Risk After It Occurred

Proposed ASC 815-20-25-3(d)(ix) requires entities to document, at hedge inception, the "method that will be used to identify a hedged transaction with an undocumented hedged risk after it occurred." Proposed ASC 815-20-25-22F states that the method should be "reasonable," but it does not include an example. ASC 815-30-55-1T provides examples such as "timing, risk, location or supplier"; however, the example in proposed ASC 815-30-55-162(c)(3) seems to apply the criterion "transactions that occurred with an undocumented hedged risk that have not yet affected reported earnings."

Paragraph BC40 states that 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." Without additional guidance, it is unclear whether there are any constraints on the nature of the identification method that could be applied. For example, it is unclear whether an entity could designate a method that would identify as the hedged forecasted transaction any eligible forecasted transactions in descending order of hedge effectiveness, or whether the identification would need to be performed on the basis of the timing of occurrence or by a predetermined waterfall (e.g., transactions with risks related to three-month LIBOR, then one-month LIBOR, then six-month LIBOR). Such clarification is important because the documented identification method will dictate how an entity links amounts in accumulated other comprehensive income (AOCI) to the forecasted transactions. Also, if the documented method is applied in circumstances in which, before the end of the hedging relationship, an entity determines that a change in hedged risk and a forecasted transaction shortfall is anticipated (see our recommendation below), that method would affect the entity's hedge effectiveness assessments.

We encourage the Board to clarify in the final ASU what an entity should document for hedges of both financial and nonfinancial items as well as to provide specific examples of that documentation (e.g., in Example 24 in ASC 815-30-55-150(c)(3)). Furthermore, it would be helpful if the final ASU also provided examples of methods that the Board would not consider acceptable. We also question whether allowing an entity to identify a hedged transaction with an undocumented hedged risk on the basis of whether the transaction has affected earnings would potentially allow the entity to manipulate earnings.

Potential Sequencing/Priority Issues

The proposed ASU does not provide any guidance on how to apply the change-in-hedged risk guidance in an environment in which an entity has multiple concurrent hedging relationships. Such ambiguity could make the guidance difficult to apply and lead to diversity in practice.

Consider the proposed example in ASC 815-30-55-150. Also assume that as part of its risk management strategy, the entity entered into a separate hedging relationship to mitigate the risk associated with its July soybean purchases and designated a forward contract that settles in July as the hedging instrument. Under the guidance in the proposed ASU, it is unclear whether the entity would need to fulfill any shortfalls in the June forecasted transaction for the June hedge before assessing whether there is a shortfall in the forecasted July purchases for the July hedge.

Similarly, proposed Case C in ASC 815-30-55-156 through ASC 815-30-55-157 illustrates a scenario in which an entity does not identify a shortfall in forecasted transactions until after the transactions have occurred. When an entity makes purchases every month, a common risk management strategy is to enter into unique hedging relationships for each subsequent month's purchases. If such a situation existed, should the entity consider a portion of subsequent month purchases as "delayed" purchases to make up the shortfall in the hedged June 20X1 purchases? For example, the entity may consider the shortfall in June 20X1 purchases to be a one-time event and use 100 bushels of July 20X1 purchases to make up the shortfall in forecasted transactions for the hedge of June 20X1 purchases. If so, a 100-bushel shortfall would be rolled forward indefinitely to the hedging relationships for subsequent months because a 100-bushel shortfall would be created for the July purchases (assuming that the July purchases were accurately forecasted as 1,000 bushels), which in turn would create a shortfall in forecasted transactions for future months' hedges. An entity could even accumulate shortfalls every month, which would only be viewed as a missed forecast when the cumulative shortfall exceeded two months' worth of purchases.

The final ASU should clarify how an entity should consider concurrent hedging relationships in its hedge documentation. For example, the Board could provide implementation guidance in the final ASU that would state that an entity with concurrent hedging relationships would need to document at hedge inception for each hedging relationship whether forecasted transactions designated in another hedging relationship would be considered eligible forecasted transactions if there was a need to fill a shortfall in designated forecasted transactions.

Additional Observation on Hedge Documentation

We believe that the method for identifying a hedged transaction with an undocumented hedged risk that an entity documents at hedge inception should also be used when an entity reevaluates its best estimate of the expected hedged risk in accordance with proposed ASC 815-30-35-37B and determines that (1) a shortfall in the forecasted transactions is expected and (2) the hedged risk is changing for a portion of its forecasted transactions.

For instance, in proposed Case A of Example 24 in ASC 815-30-55-151 and ASC 815-30-55-152, it is assumed that Entity A identifies on March 31, 20X1, that it expects the index for the forecasted purchase of all 1,000 bushels of soybeans in June 20X1 to change from the ABC soybean index to the XYZ soybean index. However, what if Entity A typically purchases soybeans on the basis of three different soybean indexes at the same location (e.g., the ABC soybean index, the DEF soybean index, and the XYZ soybean index). Also, assume that the ABC and DEF soybean indexes are typically more highly correlated with each other than the XYZ soybean index. Entity A may designate a derivative based on the ABC soybean index as its hedging instrument, and document its method of identifying forecasted purchases with an undocumented hedged risk as soybean purchases based on the DEF soybean index, before purchases of any soybeans on the basis of the XYZ soybean index. If Entity A initially forecasts that it will purchase 1,000 soybeans based on the ABC soybean index in June 20X1, but then there is an expected shortage of soybeans based on the ABC soybean index identified in March 20X1, it will have to revise its estimated sourcing of soybean purchases, which may include purchases of soybeans based on both the DEF soybean index and the XYZ soybean index. We believe that when performing the hedge effectiveness assessments in March 20X1, Entity A should have to apply its documented method for identifying forecasted purchases with an undocumented hedged risk in determining the new best estimate of the hedged risk for the forecasted transactions at the individual transaction level, as required under ASC 815-20-55-23A.

The proposed amendments currently only require application of the documented method if a shortfall is discovered at the end of the originally specified hedge period after the forecasted transaction occurs; however, it seems inconsistent to allow an entity to use a different method to determine its best estimate of the hedged risk for use in prospective hedge effectiveness assessments when the entity anticipates that a shortfall will occur. The wording of ASC 815-20-25-3(d)(1)(ix) should be amended to indicate that the designated method also should be used when a shortfall in the hedged transaction is anticipated.

Other Editorial Suggestions

ASC 815-20-25-3 highlights the importance of concurrent designation and documentation of a hedging relationship at hedge inception and states that without such documentation, "an entity could retroactively identify . . . a hedged transaction . . . to achieve a desired accounting result." In the absence of additional guidance on how an entity may establish a documented method of identifying forecasted transactions with an undocumented hedged risk, it is unclear whether the proposed amendments would allow an entity to retroactively designate the hedged risk and make up shortfalls in the hedged transaction by retroactively "tagging" transactions that occurred in the two months after the designated hedge period, which seems inconsistent with the principle in ASC 815-20-25-3. The Board should consider amending this language to be consistent with its new model.

Further, ASC 815-20-25-3(d)(1)(vi) indicates that an entity must describe the hedged forecasted transaction "with sufficient specificity so that when a transaction occurs, it is clear whether that transaction is or is not eligible to be identified as the hedged transaction regardless of the hedged risk." That paragraph also provides an example in which the forecasted transaction "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)." However, it appears as though every unit sold during the three-month period would be eligible to be the hedged transaction if an entity identified the forecasted transaction as the sale of the last 15,000 units sold during a three-month period, even if there was no shortfall of forecasted sales. Further, it is unclear whether an entity could simply identify that it is hedging the forecasted sale of 15,000 units during a three-month period that crosses over reporting periods (e.g., February 15–May 15). Assume that the entity typically sells 10,000 units per month. Every sale during that three-month period would be an eligible hedged transaction when it occurred. As long as there were more than 15,000 units sold with the original designated hedged risk within that three-month period, an entity would not even need to refer to its method of identifying transactions that occurred with an undocumented hedged risk. Could that entity then choose the period in which it wanted to have the amounts reclassified from accumulated other comprehensive income by using hindsight to identify which 15,000 unit sales were the hedged transactions? The Board should consider clarifying the wording in ASC 815-20-25-3 as well as that in ASC 815-20-55-21, which contains a similar example. Clarification of these paragraphs may also require a change to the penultimate sentence in ASC 815-20-55-26.

Other Issues Related to the Application of Hindsight

The requirement in proposed ASC 815-30-35-37C for an entity, in certain circumstances, to use hindsight to identify hedged transactions after they occur could result in additional concerns. We recall the dangers noted by the Group of 30 related to the use of derivatives in a poorly controlled environment. In Statement 133, the Board helped to address those concerns by making the application of hedge accounting dependent on an entity's preparation of specific documentation at the inception of a hedging relationship. The proposed ASU's incorporation of the use of hindsight into the change-in-hedged-risk accounting model may weaken some of these safeguards and potentially allow manipulation of the timing of earnings, depending on the required level of specificity in an entity's documentation of how it will identify a hedged transaction with an undocumented hedged risk.

For example, if an entity designates a purchase of 1,000 bushels of soybeans as the forecasted transaction in a cash flow hedge and later identifies a shortfall in the designated forecasted purchases in the originally specified hedge period, the proposed amendments could require the entity to choose which purchases in the subsequent two-month period it would like to designate as the hedged item. In such a scenario, it would be assumed that (1) there are multiple eligible transactions whose risk differs from the most recently documented hedged risk and (2) the entity's documented method for identifying hedged transactions with an undocumented hedged risk permits that level of flexibility (as noted above, there do not appear to be many constraints on what methods an entity may use to identify forecasted transactions with an undocumented risk). If the additional two-month period spans two quarters (i.e., includes December and January 202X for a calendar-year-end entity), the entity could potentially identify as the designated forecasted transaction purchases that would affect earnings in the period of its choice.

In addition, the proposed ASU's guidance on the application of the hindsight provisions could result in financial reporting that is inconsistent with the economic results of an entity's risk management activities, which would contradict one of the objectives of ASU 2017-12.[2] When, under proposed ASC 815-30-35-37C, an entity applies hindsight to identify forecasted transactions to make up for a shortfall in designated forecasted transactions with the entity's best estimate of the hedged risk, the entity is not required to assess whether its hedging instrument would have been highly effective at offsetting changes in the cash flows of those forecasted transactions with a risk other than the entity's best estimate.

This fact is also illustrated in proposed Case B of Example 24 in ASC 815-30-55-153 through ASC 815-30-55-155. In that example, although the change in estimated hedged risk is not identified

[2] FASB Accounting Standards Update No. 2017-12, *Targeted Improvements to Accounting for Hedging Activities*.

until the end of the period in which the forecasted transactions occur, the entity is not required to perform an effectiveness assessment for those forecasted transactions for which an undocumented risk has been identified; however, all of the benefits of hedge accounting are maintained.

Paragraph BC45 states that 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." That paragraph also indicates the Board's belief that entities acting 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."

The principle that hedging relationships should be highly effective was a foundation of the hedge accounting model established by Statement 133. Paragraph 386 of the Basis for Conclusions of Statement 133 noted that the requirement that an entity must expect that a hedging relationship will be highly effective "is consistent with the Board's fourth fundamental decision, which is that one aspect of qualification for special hedge accounting should be an assessment of the effectiveness of a derivative in offsetting the entity's exposure to changes in fair value or variability in cash flows."

We do not believe that the change-in-hedged-risk guidance should allow an entity to apply hedge accounting to a hedging relationship that never would have qualified as highly effective had the revised hedge risk been known at hedge inception. Allowing the application of hedge accounting in such circumstances could result in financial reporting that is inconsistent with an entity's actual risk management practices because that reporting would portray a highly effective hedging relationship that did not exist. Furthermore, the ability to obtain hedge accounting for hedging relationships that never would have been highly effective seems inconsistent with (1) the requirement in ASC 815-30-35-37A for a hedging relationship to be highly effective prospectively if a change in the hedged risk is identified before the forecasted transaction occurs and (2) the discussion in paragraphs BC14 and BC64 of the Board's rationale for certain decisions, which identifies the highly effective threshold as a sufficient limitation on the changes made to a forecasted transaction.

<u>Other Observations Related to the Change-in-Hedged-Risk Amendments</u>

ASC 815-30-35-37B, as proposed, requires an entity to "reevaluate its best estimate of the expected hedged risk at a minimum at each quarterly assessment period." It is unclear under this guidance whether an entity could be required to perform this assessment more frequently and if so, what events would trigger such an assessment. For example, if an entity enters into a contract with a different contractually specified component between assessment dates, should the entity reassess its best estimate of the risk? How about if an entity anticipates that it will sign a new contract? For instance, consider the proposed example in ASC 815-30-55-1E, except assume that the entity did not sign the contract until May 31 and did not anticipate that the June soybean purchase would be based on the XYZ soybean index until April 30 (i.e., after its March 31 periodic effectiveness assessment). The final ASU should clarify that facts and circumstances could trigger a need to reassess the best estimate risk more frequently than quarterly.

The last sentence in proposed ASC 815-30-35-37B includes the following parenthetical: "(that is, considering all risks)." This broad phrase is used repeatedly throughout the proposed ASU (see also ASC 815-30-55-152(d) and ASC 815-30-55-155(b)). The Board should consider clarifying this language to reflect that an entity would need to assess whether a change to a hedged risk is still a "shared risk" or one that is highly correlated with the hedged risk that was originally documented.

For an entity that applies the "written option test" in ASC 815-20-25-95, the guidance in the proposed ASU is unclear about whether (1) the test need only be performed on the basis of the best estimate of the hedged risk at inception or (2) a change in the hedged risk would trigger a need to reperform the test. If the Board's intention is that an entity should reperform the test if the hedged risk changes, the final ASU should clarify which data should be used to reperform the test.

Cash Flow Hedges of Interest Rate Risk

For cash flow hedges of interest rate risk, we recommend that the final ASU more clearly explain whether the number of payments is considered part of the hedged risk or the forecasted transaction. Proposed ASC 815-30-55-1N states that "the tenor of an interest rate index is considered an attribute of the hedged risk." Proposed ASC 815-30-35-37D further notes that "the number and timing of the forecasted interest rate receipts or payment also may change within the hedge period. Those changes shall not be considered changes to the critical terms . . . 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." However, Example 16 as amended, starting in ASC 815-30-55-94, seems inconsistent with this guidance. ASC 815-30-55-96A notes that the hedged transaction originally is "a cash flow hedge of 40 individual probable quarterly interest payments" and that "[i]f 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." ASC 815-39-55-98B further states that if "Entity A determined 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 . . . Entity A should reclassify into earnings from [AOCI] the amount of the net derivative instrument gain or loss related to those specific nonoccurring forecasted transactions."

Case A of Example 21, which begins in ASC 815-30-55-129, also seems inconsistent with the guidance in the proposed ASU and may require amendment. It discusses the hedging of 40 quarterly payments in a forecasted issuance of fixed-rate debt. If the forecasted transaction is not necessarily a specific number of payments but rather interest that covers a particular period, the Board should consider amending the example to discuss the period for which there would be no interest paid. Further, it would be helpful if the example discussed a scenario in which the entity issued the debt two months late, and the debt had semi-annual interest payments instead of quarterly payments, to demonstrate how the revised model would work. It is unclear whether the entity would need to reclassify an amount out of AOCI into earnings related to the first quarterly payment that will not occur even though interest starts accruing two months later and is based on a different tenor than originally expected. In our experience, entities generally do not know the terms of the debt they are going to issue very far in advance, so this problem is likely to arise in practice. In addition, the Board should consider whether the language in ASC 815-20-25-15(j)(2) should be amended to clarify that the number of interest payments or receipts is not considered part of the forecasted transaction but is instead an attribute of the hedged risk.

Hedging interest receipts on a portfolio of prepayable loans that can change in tenor will be highly complex under the proposed ASU's guidance because an entity may need several payments of shorter tenor to substitute for a missing payment, or a portion of a longer tenor payment to fill in for a missing estimated payment. The dates on which those payments reset also will be different from the date on which the hedging swap resets. For example, assume that an entity was hedging quarterly three-month LIBOR interest receipts and some loans prepaid one to two months before the next receipt date. If an entity uses receipts from one-month LIBOR loans to make up the shortfall, it has to make sure there were three consecutive payments that were not designated in another hedging relationship and recognize that those payments each would have reset dates that were based on a different one-month LIBOR on different reset dates. Alternatively, an entity may have to use a portion of a six-month/semi-annual interest payment received in that month to make up a shortfall, and the interest receipt may have been based on six-month LIBOR that was fixed six months ago even though the current settlement on the hedging interest rate swap was still exposed to changes in three-month LIBOR until three months ago. Any hypothetical swap used to the assess hedge effectiveness would be very complex and potentially have a different proportion of repricing/tenors over different periods. It is unclear whether the hypothetical derivative is supposed to match (1) all of the historical best estimates, as they were revised, and then (2) one uniform best estimate for the remaining term. The Board should consider providing implementation guidance in the final ASU since such scenarios are likely to arise in practice.

Hedging Transactions in a Group

The final ASU should clarify the difference between "hedged risk" and "risk exposure" for hedges of a group of transactions. ASC 815-20-55-23, as amended by the proposed ASU, would seem to indicate that a risk exposure is broader than a hedged risk, but the term "risk exposure" is not defined in the proposed ASU.

Further, paragraph BC64 indicates that interest payments that vary with different indexes may be hedged together if they are highly correlated. Therefore, it appears that under the guidance in the proposed ASU, transactions hedged in a group need to share similar, but not necessarily the same, hedged risk. We recommend that the Board move the guidance included in paragraph BC64 into the Codification. The Board also should consider using a term such as "similar risk" rather than "shared risk" to better embody the notion of risk correlation versus matching. In addition, the Board should consider providing implementation guidance in the portfolio cash flow hedge guidance that is similar to what already exists in the fair value hedging area (e.g., the concept espoused in ASC 815-20-55-14). Also, in a manner consistent with our recommendation above, if the Board decides to use the term "similar risk" instead of "shared risk," conforming changes should be made throughout ASC 815 (e.g., ASC 815-20-55-14 should be updated).

The final ASU should further clarify that if an entity is hedging a portfolio of items with different hedged risks, each different hedged risk needs to be highly correlated with each of the other risks in the group. Otherwise, an entity may compose a hypothetical derivative that as a whole is highly effective compared with the hedging instrument, which may mask the existence of dissimilar members in the group. For example, if an entity is hedging the purchase of 1,000 soybeans with a forward contract based on the soybean ABC index, but its forecasted purchases of soybeans are 400 soybeans based on the ABC index, 400 soybeans based on the DEF index, and 200 soybeans based on the XYZ index, it cannot simply compare the aggregate fair value of three separate hypothetical forward contracts (400 notional of ABC, 400 notional of DEF, and 200 notional of XYZ) to the actual hedging forward. Each of the separate items must be similar to each other.

Possible Effects on Application of Shortcut Method

For hedges of 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, ASC 815-20-25-3(d)(1)(viii) requires an entity to document at hedge inception its "best estimate" of the hedged risk (i.e., the contractually specified interest rate). Under the proposed ASU, it is unclear whether an entity's "best estimate of the contractually specified interest rate" equates to the "designated hedged" risk referred to elsewhere in ASC 815. For example, ASC 815-20-25-106(g) remains unchanged under the proposal, and allows the use of the shortcut method, if, among other conditions, "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 risk being hedged for that hedging relationship." If, under the proposed amendments, the designated contractually specified interest rate represents the entity's best estimate of the hedged risk, the proposed accounting model would appear to allow an entity to apply the shortcut method to all hedges of choose-your-rate debt if an entity's best estimate is that it will choose the same interest rate index during the term of the hedging relationship and that interest rate index matches the interest rate index in the interest rate swap. It would be helpful to understand whether the Board's intent is that no quantitative effectiveness testing would be required for such hedges. If so, it is possible that hedging relationships in which the shortcut method is applied could subsequently end up being hedging relationships that no longer even qualify for hedge accounting if the entity selects another interest rate index and the hedging relationship is no longer highly effective.

Implementation Examples

We believe that stakeholders would benefit from the inclusion of an example illustrating the application of the amendments to choose-your-rate debt instruments given the widespread use of such instruments in practice. Specifically, it would be helpful if the example addressed (1) how an entity would account for its election to change the contractually specified interest rate, (2) whether an entity could apply the shortcut method to its hedge of the choose-your-rate debt if one of the contractually specified interest rates that could be selected matches the interest rate index in the swap (per ASC 815-20-25-106(g)), and (3) whether an entity's past practice of selecting different rates would affect its ability to always assume that the same best estimate of the hedged risk would not change during life of the debt (ASC 815-30-55-1M(a) implies that an entity may only use a "single contractually specified interest rate" as its best estimate).

For the examples already included in the proposed ASU, it would be helpful if the Board specified the form and content of the required hedge documentation addendums that describe a change in hedged risk.

The Board also should consider clarifying whether an entity is still allowed to designate its forecasted transactions with a level of specificity that does not permit a change in designated risk. For example, would an entity be able to designate a forecasted purchase of cocoa beans based on the ABC cocoa bean index as its forecasted transactions as opposed to designating the forecasted transactions as cocoa bean purchases with a best estimate risk of ABC cocoa bean prices? We also recommend that the Board consider whether these requirements would affect the existing guidance in ASC 815-20-55-88 through ASC 815-20-55-99 and ASC 815-30-55-52 through ASC 815-30-55-60.

Hedges of Foreign Exchange Risk

We encourage the Board to consider including hedges of foreign exchange risk within the scope of the change-in-hedged-risk guidance. Our understanding is that it is not uncommon in practice for changes to occur in the hedged risk in foreign currency hedging relationships. Such changes will trigger the recognition of a missed forecast. We do not see any basis for excluding such hedges from the scope of the amendments.

Other Recommended Edits

Additional recommendations the Board should consider include the following:

- Both ASC 815-30-55-57 and ASC 815-30-55-61 state in effect that immediate reclassification is required (and permitted) only if it becomes probable that the hedged transactions (forecasted interest payments) will not occur. We recommend the guidance be worded more precisely to align with ASC 815-30-40-4, which requires amounts to remain in AOCI "unless it is probable that the forecasted transaction will not occur by the end of the originally specified time period . . . or within an additional two-month period of time thereafter.").
- Amend ASC 815-20-35-2C and 815-20-55-79G to explicitly state that if there is a change in the best estimate of the hedged risk, an entity would be required to perform a quantitative assessment or at least reconsider whether it is still appropriate to perform qualitative effectiveness assessments.
- Amend the example in ASC 815-20-55-91 through 55-96 to incorporate the concepts of best estimate of interest rate index and tenor/frequency.
- In Example 9 in ASC 815-30-55-55, remove the reference to "contractually specified interest rate" because the referenced notes are fixed rate debt.
- Consider whether Case B, which begins in ASC 815-20-55-97, should be updated to reflect the amendments in the proposed ASU. We recommend that the Board clarify that the hedged risk is the entity's best estimate or add guidance indicating that since the debt does not permit an option to choose different rates/tenors, the risk is not estimated.
- Amend Example 7, which begins in ASC 815-20-55-106, to clarify that (1) the debt is based on three-month LIBOR, (2) the forecasted interest payments also would include those related to any replacement debt (to avoid conflict with ASC 815-20-55-97), and (3) because the potential replacement debt is included in the designation of the hedged item, the entity must document its best estimate of the hedged risk, even if the current debt has only one contractually specified interest rate, because that debt may be replaced.
- We do not understand the purpose of the proposed phrase in ASC 815-30-55-1F "and the retrospective hedge effectiveness assessment based on the 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." Either way, the timing of the reclassification of amounts already recorded in AOCI would not be affected.

- In proposed ASC 815-30-55-24, the last three sentences discuss why the hedging relationship achieves perfect offset. We recommend that the Board add a condition requiring that the variable rate in the swap be the contractually specified interest rate in the debt instrument.
- In proposed ASC 815-30-55-41, the second sentence refers to "the contract" for a forecasted purchase. We recommend that the Board consider changing "The contract does not" to "The forecasted purchases do not."
- In the second sentence of proposed ASC 815-30-55-42, either (1) explain that the entity is using the cost of corn delivered to Minneapolis because Minneapolis pricing is its best estimate of the hedged risk or (2) add to the facts in ASC 815-30-55-42 that the purchases must occur in Minneapolis and there are no other ways to get the corn. In addition, we recommend that the guidance in ASC 815-30-55-46 also state that the purchases were made in Minneapolis or based on Minneapolis corn prices.
- In proposed ASC 815-30-55-1I, change the ending from "when it occurs" to "when it is qualified to be a hedged item."
- In proposed ASC 815-30-55-152(a), change the reference in first sentence from ASC 815-30-35-1Q to ASC 815-30-55-1Q.
- In proposed ASC 815-30-55-157(b), the first sentence starts "Entity A could identify . . . ." It is unclear why the word "could" is used instead of "should."
- Proposed ASC 815-30-55-160 uses the word "settlements" rather than "payments." Interest payments on debt are not considered settlements. We recommend changing the term to "payments" twice in the second sentence.
- Clarify in proposed ASC 815-30-55-166(c) that there were no May purchases of cocoa beans indexed to the ABC cocoa bean index. Otherwise, wouldn't those cocoa beans be considered the delayed forecasted transactions before the DEF cocoa bean purchases in April?
- Remove the last sentence in paragraph BC53 given that there cannot be any more hedge effectiveness assessments after the forecasted transaction occurred because hedge accounting has ceased.

Issue 2: Amendments Related to Contractually Specified Components

In general, we believe that before the occurrence of a forecasted transaction, an entity should have evidence of a binding agreement that specifies the pricing of the hedged forecasted transaction in order to designate a contractually specified component as the hedged item.

The Board should consider changing the second sentence of proposed ASC 815-20-25-22C as follows: "A contractually specified component is evidenced by documentation that supports *that the contractually specified component was a variable component of* the price at which a nonfinancial asset is purchased or sold." We believe that the timing of obtaining documentation is less relevant than the fact that it represents evidence of an enforceable contract; however, the contract or other supporting documentation should be enforceable before a purchase or sale.

Some might conclude that in the last sentence in paragraph BC75, the "did not intend for that to be a limiting factor" language implies that not even a receipt or documentation is needed to support a contractually specified component. That is not our interpretation because such a reading would conflict with the proposed guidance in ASC 815-20-25-22C. However, the Board should consider clarifying that a spot receipt only qualifies as appropriate support for a contractually specified component if it explicitly references that component.

The final ASU also should clarify the appropriate accounting treatment to apply when (1) there is no agreement supporting a contractually specified component at the time of hedge designation and (2) upon consummation of the transaction, the receipt does not explicitly reference the contractually specified component. Is it the Board's intent that the previous application of hedge accounting for this hedging relationship would be treated as an accounting error?

Proposed ASC 815-20-25-22E(d) states that 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." In previous deliberations, the Board seemed to reject the idea that a contractually specified component could be identified on the basis of market convention; however, the quoted language seems to incorporate a market convention notion. The final ASU should provide examples of an appropriate spot market pricing formula. The concept of a such a formula does not align with what we have seen in practice.

Proposed ASC 815-20-25-22E refers to the implementation guidance in ASC 815-30-55-1B through 55-1E as related implementation guidance, but the examples therein seem more applicable to ASC 815-20-25-22D. We recommend that the final ASU include implementation guidance that can better demonstrate the concepts in ASC 815-20-25-22E.

Proposed ASC 815-20-25-15B would allow a forecasted transaction that is accounted for as a derivative to be the hedged item. While we support the addition of that paragraph, we believe that the use of the word "contract" in proposed ASC 815-20-25-15B(a) is too restrictive and recommend that the Board consider replacing "contract" with "transaction." We understand the Board's rationale for excluding bookouts from the scope of the proposed ASU, as stated in paragraph BC94; however, we encourage the Board and its staff to continue to explore whether some type of mechanism could be identified that would allow entities to hedge bookouts in a manner similar to spot purchases. (Under such arrangements, the forecasted purchases still may ultimately occur in the spot market.) For example, could the language in proposed ASC

815-20-25-15B be amended to require that the transaction's occurrence is probable instead of requiring physical settlement of the contract?

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 not-for-profit entities that have issued, or are 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?

No, we do not believe that special considerations are required for private companies that are not financial institutions and not-for-profit entities. The concerns we have raised in our response to Questions 1–3 apply to all entities.

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.

Please refer to our response to Questions 1–3.

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?

No, we are not aware of a need for transition guidance for hedges of credit risk. As noted in our response to Questions 1–3, we recommend that hedges of foreign exchange risk be kept within the scope of the amendments.

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 changes 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.

We recommend that the Board consider whether the guidance in ASC 815-20-65-6(b) is appropriate for all entities with existing hedges. The guidance in this paragraph would require all entities to amend the documentation for all cash flow hedges that exist as of the adoption date so that it specifies a method that would be used to identify a hedged transaction with an undocumented hedged risk. In practice, it is not uncommon for many entities to have one simple hedge in place for their plain-vanilla variable-rate debt. Such entities may rely on the expertise of third-party advisers and may not have been following the Board's deliberations closely. The Board may want to consider whether it would be appropriate to grandfather existing cash flow hedging relationships for smaller entities, or private companies that are not financial institutions and not-for-profit entities, into this requirement. Does the Board intend for such entities to lose hedge accounting if they do not amend the hedge documentation to specify the methods that would be used to identify a hedged transaction with an undocumented hedged risk?

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?

We support the proposed effective dates if the final ASU is issued in the first half of 2020. However, we recognize that our recommendations may require significant changes to the proposed guidance, and we are happy to work with the staff to provide additional perspectives on the development of a final ASU, which would most likely require more time.