FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: September 25, 2024
Comments Due: November 25, 2024

Derivatives and Hedging (Topic 815)

Hedge Accounting Improvements

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. 2024-ED200, FASB, 801 Main Avenue, 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 November 25, 2024. 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. 2024-ED200
- Sending a letter to "Technical Director, File Reference No. 2024-ED200, FASB, 801 Main Avenue, 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.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

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Hedge Accounting Improvements

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Summary and Questions for Respondents

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

The FASB is issuing this proposed Update to clarify certain aspects of the guidance on hedge accounting and to address several incremental hedge accounting issues arising from the global reference rate reform initiative.

In 2017, the FASB issued Accounting Standards Update No. 2017-12, *Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities,* to better portray the economic results of an entity's risk management activities in its financial statements and to make certain targeted improvements to simplify the application of the hedge accounting guidance. After the issuance of Update 2017-12, stakeholders asked the Board to clarify certain aspects of the guidance in the amendments of that Update. In 2019, the Board issued a proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting,* to clarify certain areas of the guidance to better align with the objective articulated in Update 2017-12.

Stakeholders indicated that the amendments in the 2019 proposed Update would not sufficiently resolve certain issues and that additional clarity was needed. In addition, in response to the 2021 Invitation to Comment, *Agenda Consultation,* stakeholders expressed concerns that current guidance increases the prevalence of missed forecasted transactions for otherwise highly effective hedging relationships, thus resulting in less decision-useful information for investors. Stakeholders also identified several areas of hedge accounting guidance requiring further updates to address the effects of reference rate reform on hedge accounting.

Consistent with the original objective of Update 2017-12, the objective of this proposed Update is to more closely align hedge accounting with the economics of an entity's risk management activities. The amendments included in the five issues addressed in this proposed Update are intended to better reflect those strategies in financial reporting by enabling entities to achieve and maintain hedge accounting for a greater number of highly effective economic hedges. The proposed amendments would limit the occurrence of unintuitive

dedesignation events and missed forecasted transactions for those hedging relationships.

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

Issue 1: Similar Risk Assessment for Cash Flow Hedges

The amendments in this proposed Update would expand the hedged risks permitted to be aggregated in a group of individual forecasted transactions in a cash flow hedge by changing the requirement to designate a group of individual forecasted transactions from having a *shared* risk exposure to having a *similar* risk exposure. Entities would be required to assess risk similarity both at hedge inception and on an ongoing basis. The proposed amendments also would clarify that a group of individual forecasted transactions would be considered to have a similar risk exposure if the derivative used as the hedging instrument is highly effective against each risk in the group. In addition, in some cases, entities would be permitted to perform an ongoing qualitative assessment of whether a group of individual forecasted transactions has a similar risk exposure on a hedge-by-hedge basis.

The amendments in this proposed Update would improve GAAP by expanding the hedged risks permitted to be aggregated in a group of individual forecasted transactions, thereby enabling entities to apply hedge accounting to broader portfolios of forecasted transactions. Entities would be able to apply hedge accounting in a more efficient, cost-effective manner while reducing the risk of missed forecasts for highly effective economic hedges. Furthermore, clarifying the application of the similar risk assessment would improve operability and help entities apply the guidance more consistently. Therefore, investors would

have more relevant information about entities' risk management activities related to cash flow hedges of groups of forecasted transactions.

Issue 2: Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments

The amendments in this proposed Update would facilitate the application of the change in hedged risk guidance to cash flow hedges of forecasted interest payments on variable-rate debt instruments with contractual terms that permit the borrower to change the interest rate index and interest rate tenor (that is, reset frequency) upon which interest is accrued (commonly referred to as "choose-your-rate" debt instruments). The contractual terms of the debt agreement would determine the alternative interest rate indexes and interest rate tenors that an entity may select during the hedging relationship without needing to discontinue hedge accounting. In addition, the proposed amendments would permit entities to use simplified assumptions when assessing hedge effectiveness and the probability of forecasted transactions occurring. Entities would be prohibited from applying this simplified guidance by analogy to other circumstances.

The amendments in this proposed Update would improve GAAP by establishing an operable model to address a pervasive hedging strategy for which stakeholders highlighted that diversity in practice exists. Furthermore, the amendments would enable entities to reduce the risk of hedge dedesignation events and missed forecasts, while broadening the application of hedge accounting. As a result, entities would be able to more consistently reflect risk management strategies in the financial information provided to investors.

Issue 3: Cash Flow Hedges of Nonfinancial Forecasted Transactions

The amendments in this proposed Update would expand hedge accounting for forecasted purchases and sales of nonfinancial assets. Entities would be permitted to designate variable price components of the forecasted purchase or sale of a nonfinancial asset that meet the clearly-and-closely-related criteria within the normal purchases and normal sales scope exception. Relative to current GAAP, which limits designation of nonfinancial components to those that are contractually specified, a model based on the clearly-and-closely-

related criteria would permit hedge accounting for eligible components of forecasted spot-market transactions and subcomponents of explicitly referenced components in an agreement's pricing formula.

The amendments in this proposed Update would improve GAAP because the application of hedge accounting would not necessarily be limited by whether the nonfinancial purchase or sale transaction is executed in the spot or forward market. Furthermore, the proposed amendments also may enable entities to reduce the risk of missed forecasts for highly effective economic hedges, more closely aligning entities' risk management strategies with hedge accounting to better reflect those strategies in financial reporting.

The amendments in this proposed Update also would clarify that entities may designate a variable price component in a contract that is accounted for as a derivative as the hedged risk if the associated forecasted purchase or sale of the nonfinancial asset qualifies to be a hedged forecasted transaction. That clarification would improve GAAP because it would resolve diversity in practice about whether hedge accounting may be applied in those situations and would allow hedge accounting to be applied to highly effective economic hedges.

Issue 4: Net Written Options as Hedging Instruments

The amendments in this proposed Update would permit compound derivatives composed of a written option and a non-option derivative (for example, an interest rate swap with a written cap or floor) to qualify for designation as a hedging instrument in a cash flow hedge by adjusting the eligibility criteria for when a net written option may be designated as a hedging instrument. The proposed amendments would permit an entity to assume that certain terms of the hedged forecasted transactions match those of the hedging instrument for purposes of applying the net written option test.

The amendments in this proposed Update would improve GAAP by making the net written option test more operable for hedging relationships involving a variable-rate loan with an interest rate floor hedged by an interest rate swap that contains a mirror-image interest rate floor. The proposed amendments would accomplish that by allowing simplifying assumptions to be made that would accommodate differences in the loan and swap markets that exist after the cessation of the London Interbank Offered Rate (LIBOR). Making those simplifying assumptions would allow entities to continue to apply hedge

accounting for strategies involving compound derivatives composed of a written option and a non-option derivative after LIBOR cessation.

Issue 5: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

The amendments in this proposed Update would eliminate the recognition and presentation mismatch related to a dual hedge strategy (that is, a hedge for which a foreign-currency-denominated debt instrument is both 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). The proposed amendments would require that an entity exclude the debt instrument's fair value hedge basis adjustment from the net investment hedge effectiveness assessment. As a result, an entity would immediately recognize in earnings the gains and losses from the remeasurement of the debt instrument's fair value hedge basis adjustment at the spot exchange rate. Entities would be prohibited from applying this guidance by analogy to other circumstances.

The amendments in this proposed Update would improve GAAP by enabling entities that utilize dual hedging strategies to reflect the economic offset of changes attributable to both interest rate risk and foreign exchange risk.

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

The effective date for the amendments in this proposed Update will be determined after the Board considers stakeholders' feedback on the proposed amendments.

The amendments in this proposed Update would require that an entity apply the guidance on a prospective basis for existing hedging relationships as of the date of adoption. Early adoption would be permitted for all entities on any date on or after issuance of a final Update.

Upon adoption of the amendments in this proposed Update, entities may either be required or permitted to modify critical terms of certain existing hedging relationships, without dedesignating the hedge.

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—Similar Risk Assessment for Cash Flow Hedges: Do the amendments in this proposed Update clarify and improve the guidance on cash flow hedges of individual forecasted transactions hedged as a group? In addition, are the proposed amendments clear and operable? Please explain why or why not. If not, what changes would you suggest?

Question 2—Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments: Do the proposed amendments clarify and improve the guidance on cash flow hedges of interest payments on choose-your-rate debt instruments? In addition, are the proposed amendments clear and operable? Please explain why or why not. If not, what changes would you suggest?

Question 3—Cash Flow Hedges of Nonfinancial Forecasted Transactions: Do the proposed amendments clarify and improve the guidance on cash flow hedges of nonfinancial forecasted transactions? In addition, are the proposed amendments, including those that require the application of the clearly-and-closely-related assessment, clear and operable? Please explain why or why not. If not, what changes would you suggest?

Question 4—Net Written Options as Hedging Instruments: Do the proposed amendments improve the guidance on net written options as hedging instruments? Please explain why or why not. If not, what changes would you suggest? In addition, the Board rejected an alternative to the proposed amendments related to the net written option test in paragraph 815-20-25-88 that would have removed the test from Topic 815 (see paragraph BC81). Do you have any views on the alternative rejected by the Board and whether it would be more operable, be less complex, and provide more decision-useful information compared with the proposed amendments?

Question 5—Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge): Do the proposed amendments improve the guidance on a foreign-currency-denominated debt instrument that is used as the hedging instrument and hedged item (commonly referred to as a "dual hedge")? In addition, are the proposed amendments on dual hedges clear and operable? Please explain why or why not. If not, what changes would you suggest?

Question 6—Transition: Are the proposed transition requirements operable? If not, why not, and what transition method would be more appropriate and why? Would the proposed transition disclosures be decision useful? Please explain why or why not.

Question 7—Effective Date: In evaluating the effective date, how much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities be different from the effective date for public business entities? Please explain why or why not. If the effective dates should be different, how much additional time would entities other than public business entities need to implement the proposed amendments?

Question 8—General: Do you expect any unintended consequences of providing these proposed amendments? If so, please explain what those unintended consequences would be.

Question 9—Benefits and Costs: Would the expected benefits of the proposed amendments justify the expected costs? If not, please describe the nature and magnitude of those costs, differentiating between one-time costs and recurring costs.

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 Section	Description of Changes
Subtopic 815-20, Derivatives and Hedging—Hedging—General	**Issue 1: Similar Risk Assessment for Cash Flow Hedges** • Amended paragraph 815-20-25-3 to require formal documentation, at hedge inception, of the method that will be used to determine whether a group of individual forecasted transactions have a similar risk exposure. • Amended paragraph 815-20-25-15 to clarify that a group of individual transactions must have a similar risk exposure to be designated as a hedged transaction in a cash flow hedge. • Amended paragraph 815-20-55-23 to require that individual forecasted transactions have a similar risk exposure both at hedge inception and on an ongoing basis. • Added implementation guidance in paragraphs 815-20-55-23A through 55-23D to clarify how an entity should assess whether a group of forecasted transactions in a cash flow hedge have a similar risk exposure. • Amended paragraph 815-20-55-33A to cross-reference to paragraph 815-20-55-96A.

Codification Section	Description of Changes
	• Amended paragraph 815-20-55-56 to clarify that changing the method designated to assess similar risk exposure requires the dedesignation of the original hedging relationship. • Amended the illustrative example beginning in paragraph 815-20-55-88, and added paragraph 815-20-55-89B, 815-20-55-96A, and paragraphs 815-20-55-99A through 55-99E to illustrate different approaches to designate variable interest payments on a group of variable-rate, interest-bearing loans as the hedged item. **Issue 2: Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments** • Amended paragraph 815-20-25-3 to refer to the guidance on changing the contractually specified interest rate for hedges of forecasted interest payments on choose-your-rate debt instruments. • Amended paragraph 815-20-25-79 and added paragraph 815-20-25-79B to clarify the requirements of the quantitative prospective assessment of hedge effectiveness for cash flow hedges of forecasted interest payments on choose-your-rate debt instruments. • Amended paragraph 815-20-55-56 to clarify that changes in the contractually specified interest rate on choose-your-rate debt instruments do not result in automatic dedesignation of the hedging relationship if certain conditions are met.

Codification Section	Description of Changes
	Issue 3: Cash Flow Hedges of Nonfinancial Forecasted Transactions • Amended paragraph 815-20-25-3 to require documentation of the component (or subcomponent) being designated as the hedged risk in a cash flow hedge of the forecasted purchase or sale of a nonfinancial asset. • Amended paragraph 815-20-25-15(e) to permit designation of a variable price component (or subcomponent) in a forecasted purchase or sale of a nonfinancial item under a contract that is accounted for as a derivative. • Amended paragraph 815-20-25-15(i)(3) to permit designation of the risk of changes in the cash flows relating to a component (or subcomponent) of the price of a nonfinancial asset that is clearly and closely related to the purchase price or sales price of the nonfinancial asset. • Superseded the guidance in paragraphs 815-20-25-22A through 25-22B for hedging contractually specified components in cash flow hedges of a forecasted purchase or sale of a nonfinancial asset. • Added paragraph 815-20-25-22C to provide additional criteria for designating the variability in cash flows attributable to changes in a component (or subcomponent) of the price of a nonfinancial asset as the hedged risk. • Amended paragraphs 815-20-25-46B, 815-20-25-77, 815-20-25-84, and 815-20-55-79P to remove the references to contractually specified components.

Codification Section	Description of Changes
	• Amended the navigation guidance included in paragraph 815-20-55-17 related to implementation guidance on hedged items in cash flow hedges. • Added implementation guidance in paragraphs 815-20-55-18A through 55-18D and amended paragraph 815-20-55-19 on designating a variable price component (or subcomponent) as the hedged risk in a cash flow hedge of a forecasted transaction to purchase or sell a nonfinancial asset. • Superseded the implementation guidance in paragraphs 815-20-55-26A through 55-26E on the contractually specified component model for hedging nonfinancial assets. **Issue 4: Net Written Options as Hedging Instruments** • Amended paragraph 815-20-25-88 to specify certain assumptions that may be made when performing the net written option test for cash flow hedges if the hedging instrument is a combination of a written option and any other non-option derivative instrument. **Issue 5: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)** • Amended implementation guidance in paragraph 815-20-55-38 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.

Codification Section	Description of Changes
	• Amended paragraph 815-20-55-129 of the illustrative example, which demonstrates how an entity would perform the hedge effectiveness assessment for dual hedges.
Subtopic 815-30, Derivatives and Hedging—Cash Flow Hedges	**Issue 1: Similar Risk Assessment for Cash Flow Hedges** • Amended paragraphs 815-30-55-147 through 55-148 of the illustrative example, which demonstrates an entity utilizing the similar risk assessment for a forecasted purchase of inventory. **Issue 2: Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments** • Amended paragraph 815-30-35-8 to remove a change in the designated hedged risk from the list and replace it with a change in the contractually specified interest rate for forecasted interest payments on choose-your-rate debt instruments. • Superseded paragraph 815-30-35-37A and added paragraphs 815-30-35-37B through 35-37F to provide guidance for changing the contractually specified interest rate for hedges of forecasted interest payments on choose-your-rate debt instruments. • Amended the illustrative example beginning in paragraph 815-30-55-52 to illustrate the application of the proposed guidance to changes in a cash flow hedge of forecasted interest payments with an interest rate swap. • Added paragraphs 815-30-55-165 through 55-178 to provide an illustrative example of the

Codification Section	Description of Changes
	guidance in paragraphs 815-30-35-37B through 35-37F. **Issue 3: Cash Flow Hedges of Nonfinancial Forecasted Transactions** • Amended paragraphs 815-30-55-2 through 55-4 to update the illustrative example to reflect the proposed nonfinancial component hedging model. • Amended paragraph 815-30-55-21 to update the illustrative example to reflect the proposed nonfinancial component hedging model. • Amended paragraph 815-30-55-41 to update the illustrative example to remove the reference to contractually specified components. • Amended paragraphs 815-30-55-134 and 815-30-55-138 to update the illustrative example to reflect the proposed nonfinancial component hedging model. • Amended paragraphs 815-30-55-146 through 55-148 to update the illustrative example to reflect the proposed nonfinancial component hedging model. • Added paragraphs 815-30-55-149 through 55-164 to provide illustrative examples of the proposed nonfinancial component hedging model.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–13. 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~~.

Amendments to Master Glossary

3. Supersede the Master Glossary term *Contractually Specified Component*, with a link to transition paragraph 815-20-65-7, as follows:

~~**Contractually Specified Component**~~

~~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.~~

Issue 1: Similar Risk Assessment for Cash Flow Hedges

Amendments to Subtopic 815-20

4. Amend paragraphs 815-20-25-3(d), 815-20-25-15(a)(2), 815-20-55-23, 815-20-55-33A, 815-20-55-56, 815-20-55-88 through 55-89A, 815-20-55-91 through 55-92 and their related heading, 815-20-55-94 through 55-95, and 815-20-55-97 through 55-98 and add paragraphs 815-20-55-23A through 55-23D, 815-20-55-89B, 815-20-55-96A, and 815-20-55-99A through 55-99E and their related heading, with a link to transition paragraph 815-20-65-7, 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:
    2. For a cash flow hedge of a group of forecasted transactions, the method that will be used to determine whether a group of individual forecasted transactions have a similar risk exposure in accordance with paragraph 815-20-55-23A.

> 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~~ have a similar 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.

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 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, the~~ The transactions in each group must ~~share the~~ have a similar risk exposure for which they are being hedged. ~~For example, the interest payments in the group in (c) in the preceding paragraph shall vary with the same index to qualify for hedging with a single derivative instrument.~~ To satisfy that requirement, an entity should determine whether the forecasted transactions are expected to have a similar risk exposure prospectively at hedge inception and on an ongoing basis. In addition, an entity should determine whether the forecasted transactions had a similar risk exposure retrospectively on an ongoing basis. An entity should assess similarity each time it assesses hedge effectiveness for a group (for timing of hedge effectiveness assessments, see paragraphs 815-20-25-79 through 25-79A and, for certain private companies, see paragraphs 815-20-25-139 through 25-142).

815-20-55-23A An entity should determine that the hedged risks in a group of forecasted transactions are similar by applying either of the following methods:

a. The entity determines whether the designated hedging instrument is highly effective in achieving offsetting changes in cash flows attributable to each hedged risk in the group, assessed on an individual basis, considering the guidance for assessing hedge effectiveness.
b. The entity determines whether each hedged risk related to a forecasted transaction hedged in a group is similar to each other hedged risk in the group. In that assessment, an entity should use the same threshold applied to determine whether a relationship is highly effective. When assessing whether hedged risks in a group of forecasted transactions are similar, an entity should consider the guidance in paragraph 815-20-25-79 as well as the guidance in paragraph 815-30-35-10 for hedges of interest rate risk.

Ordinarily, an entity should apply the selected method consistently to similar hedges. Use of different methods for similar hedges should be justified.

815-20-55-23B If an entity applies one of the qualitative methods in paragraph 815-20-25-3(b)(2)(iv)(01) for purposes of assessing hedge effectiveness and it applies the similar risk assessment method described in paragraph 815-20-55-23A(a), it also may assume that the hedged risks related to a group of forecasted transactions are similar.

815-20-55-23C After performing an initial quantitative assessment at hedge inception, an entity may elect on a hedge-by-hedge basis to qualitatively assess whether a group of individual forecasted transactions have a similar risk exposure in subsequent periods, if the entity can reasonably support an expectation of similar risk on a qualitative basis, in a manner similar to the guidance in paragraphs 815-20-35-2A through 35-2F. The qualitative assessment used to reasonably support an expectation of high effectiveness also may be used to support an expectation of similar risk exposure if an entity applies the similar risk assessment method described in paragraph 815-20-55-23A(a).

815-20-55-23D If an entity determines as part of its ongoing similar risk assessment that one or more hedged risks related to the group of individual forecasted transactions are no longer similar, it should dedesignate the hedging relationship as of the last date when all hedged risks in the group were assessed to have similar risk exposure, unless the entity can determine the specific date that all hedged risks in the group were no longer similar. Amounts previously recognized in accumulated other comprehensive income should remain until the forecasted transactions affect earnings or become probable of not occurring in accordance with paragraphs 815-30-40-4 through 40-6.

• • • > First-Payments-Received Technique in Hedging Variable Interest Payments on a Group of Loans

815-20-55-33A A first-payments-received technique for identifying the hedged forecasted transactions (that is, the hedged interest payments) may be used in a cash flow hedge of interest rate risk associated with interest payments for a rolling portfolio of prepayable interest-bearing loans (or other interest-bearing financial assets)~~, provided~~ if all other conditions for a cash flow hedge have been met. Such a technique involves identifying the hedged forecasted transactions in a cash flow hedge as the first interest payments based on the contractually specified interest rate received by an entity during each recurring period of a specified length and beginning date for the period covered by the hedging instrument. Example 4, Case A (see

paragraphs 815-20-55-91 through 55-96A ~~55-96~~) illustrates this technique.

• > 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 and the method of assessing similar risk exposure), 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 815-30-35-37A,~~ paragraphs 815-30-35-37B and 815-30-35-37D, for a cash flow hedge of forecasted interest payments on choose-your-rate debt (and replacements thereof), a change ~~to the hedged risk in a cash flow hedge of a forecasted transaction~~ in the contractually specified interest rate (and associated change in the number and timing of forecasted interest payments within the hedged period, if any) does not result in an automatic dedesignation of the hedging relationship if the conditions in those paragraphs are met ~~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 represent 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. **[For convenience, this paragraph also contains the amendments from Issue 2.]**

> 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~~ a single interest rate index under the first-payments-received technique (Case A)
b. Designation based on a specific group of individual loans (Case B) ~~(Case B).~~
c. Designation based on multiple interest rate indexes under the first-payments-received technique (Case C).

815-20-55-89 For Cases A, B, and C ~~A and B~~, assume that Entities A, B, and C each ~~Entity A and Entity B both~~ make to their respective customers Secured Overnight Financing Rate (SOFR-) ~~London Interbank Offered Rate- (LIBOR-)~~ indexed variable-rate loans for which monthly interest payments are based on 30-Day Average SOFR (in arrears) (that is, daily compounded average of SOFR during the past 30 days) ~~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~~. Entity C also originates SOFR-indexed variable-rate loans for which interest payments are based on both 1-Month Term SOFR (that is, 1-month forward-looking SOFR) and 30-Day Average Fed Funds Effective Rate (in arrears) (that is, daily compounded average Fed Funds Effective Rate during the past 30 days). All loans made by Entities A, B, and C have a 0 percent interest rate floor and a mix of monthly reset and payment dates. In addition, Entity C has a mix of payment conventions. ~~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.~~ **[Content amended and moved to paragraph 815-20-55-89A]**

815-20-55-89A Both ~~entities~~ Entities A and B determine that they will each always have at least $100 million of 30-Day Average SOFR-indexed (in arrears) ~~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. **[Content amended as shown and moved from paragraph 815-20-55-89]** Entity C determines that it will always have at least $100 million of variable-rate loans outstanding indexed to any combination of 30-Day Average SOFR (in arrears), 1-Month Term SOFR, and 30-Day Average Fed Funds Effective Rate (in arrears) throughout the next 3 years.

815-20-55-89B Entities A, B, and C each execute a 3-year, receive-fixed, pay-variable (30-Day Average SOFR [in arrears]) interest rate swap with a $100 million notional amount that settles at the end of each calendar month. Each interest rate swap does not include a floor and has a fair value of $0 at inception.

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 a Single Interest Rate Index under the First-Payments-Received Technique ~~First Payments Received~~

815-20-55-91 In this Case, Entity A designates the 30-Day Average SOFR (in arrears) interest rate swap (described in paragraph 815-20-55-89B) as hedging the cash flow variability attributable to changes in the first interest payments received during each month for the next 3 years on $100 million principal of 30-Day Average SOFR-indexed (in arrears) variable-rate loans. ~~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~~ Any 30-Day Average SOFR-indexed (in arrears) interest payments received by Entity A after it has received payments on $100 million aggregate principal would be unhedged interest payments for that period ~~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 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 30-Day Average SOFR (in arrears) ~~LIBOR~~ interest rate in Entity A's first ~~LIBOR-based~~ 30-Day Average SOFR (in arrears) interest payments received, any prepayment, sale, or credit difficulties related to an individual 30-Day Average SOFR-indexed (in

arrears) ~~LIBOR-indexed~~ variable-rate loan would not necessarily 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~~ 30-Day Average SOFR-indexed (in arrears) 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.

815-20-55-96A Entity A elects to assess similar risk exposure for the group of forecasted transactions by determining that the designated hedging instrument is highly effective against each hedged risk in the group in accordance with the method outlined in paragraph 815-20-55-23A(a) and determines that the similar risk exposure requirement is met. Entity A also utilizes that same assessment to satisfy the initial prospective effectiveness assessment. In performing that assessment, Entity A considers the differences between the hedged risks of the individual forecasted transactions in the group and the contractual terms of the hedging instrument. Those differences include, for example, payment dates, reset dates, and interest rate floors.

• • > Case B: Designation Based on a Specific Group of Individual Loans

815-20-55-97 In this Case, Entity B designates the 30-Day Average SOFR (in arrears) interest rate swap (described in paragraph 815-20-55-89B) as hedging the cash flow variability attributable to changes in the interest payments received during each month for the next 3 years ~~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 B receiving a fixed interest rate on a $100 million notional amount and paying a variable LIBOR-based rate on a $100 million notional amount. Entity B initially designates cash flow hedging relationships of interest rate risk and identifies as the related hedged forecasted transactions each of the variable interest receipts~~ on a specified group of individual 30-Day Average SOFR-indexed (in arrears) ~~LIBOR-indexed~~ variable-rate loans aggregating $100 million principal

~~but then some of those loans experience prepayments, are sold, or experience credit difficulties~~. Entity B elects to assess similar risk exposure in accordance with the method outlined in paragraph 815-20-55-23A(a). Consistent with the differences considered by Entity A in paragraph 815-20-55-96A, Entity B should consider differences between the respective hedged risks of the individual forecasted transactions in the group and the contractual terms of the hedging instrument, including, for example, payment dates, reset dates, and interest rate floors.

815-20-55-98 After designation, some of the specifically identified loans experience prepayments, are sold, or experience credit difficulties. This Case addresses whether the original cash flow hedging relationships remain intact if the composition of the group of loans whose interest payments are the hedged forecasted transactions is changed by replacing the principal amount of the specified loans that experience a prepayment, have been sold, or experience a change in **expected cash flows** due to credit difficulties with similar variable-rate interest-bearing loans. Entity B cannot conclude that the original cash flow hedging relationships have remained intact if the composition of the group of loans whose interest payments are the hedged forecasted transactions is changed by replacing the principal amount of the originally specified loans with similar variable-rate interest-bearing loans. Paragraph 815-20-25-15(a) requires that, for a cash flow hedge, the forecasted transaction be specifically identified as a single transaction or group of transactions. At inception, the entity designated cash flow hedging relationships for each of the variable interest receipts on a specified group of variable-rate loans. If a loan within the group experiences a prepayment, has been sold, or experiences an unexpected change in its **{remove glossary link}expected cash flows{remove glossary link}** due to credit difficulties, the remaining hedged interest payments to Entity B specifically related to that loan are now no longer probable of occurring. Pursuant to paragraphs 815-30-40-1 through 40-3, Entity B must discontinue the hedging relationships with respect to the hedged forecasted transactions that are now no longer probable of occurring. However, had the hedged forecasted transactions been designated in a manner similar to that described in Case A, the consequences of a loan's prepayment, a loan sale, or an unexpected change in a loan's expected cash flows due to credit difficulties would not have been the same. How the forecasted transaction in a cash flow hedge is designated can have a significant effect on the application of the Derivatives and Hedging Topic.

815-20-55-99 Changing the composition of the specified individual loans within the group of variable-rate interest-bearing loans due to prepayment, a loan sale, or an unexpected change in a loan's expected cash flows due to credit difficulties reflects a change in the probability of the identified hedged

forecasted transactions for the hedging relationships related to the individual loans removed from the group of variable-rate interest-bearing loans. Consequently, the hedging relationships for future interest payments that are no longer probable of occurring must be terminated. The provisions related to immediately reclassifying a derivative instrument's gain or loss out of accumulated other comprehensive income into earnings are based on the hedged forecasted transaction being probable that it will not occur—not no longer being probable of occurring—and includes consideration of an additional two-month period of time. After the discontinuation of the hedging relationships for interest payments related to the individual loans removed from the group of variable-rate interest-bearing loans and the reclassification into earnings of the net gain or loss in accumulated other comprehensive income related to those hedging relationships, the derivative instrument (or a proportion thereof) specifically related to the hedging relationships that have been terminated is eligible to be redesignated as the hedging instrument in a new cash flow hedging relationship. However, paragraph 815-30-40-5 warns that a pattern of determining that hedged forecasted transactions are probable of not occurring would call into question both the entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions.

• • > Case C: Designation Based on Multiple Interest Rate Indexes under the First-Payments-Received Technique

815-20-55-99A In this Case, Entity C designates the 30-Day Average SOFR (in arrears) interest rate swap (described in paragraph 815-20-55-89B) as hedging cash flow variability in the first interest payments received during each month for the next 3 years attributable to the contractually specified interest rates on $100 million of variable rate loans indexed to any combination of 30-Day Average SOFR (in arrears), 1-Month Term SOFR, and 30-Day Average Fed Funds Effective Rate (in arrears).

815-20-55-99B By designating the hedged forecasted transactions as the first interest payments received on 30-Day Average SOFR-indexed (in arrears), 1-Month Term SOFR-indexed, and 30-Day Average Fed Funds Effective Rate-indexed (in arrears) variable-rate loans, Entity C considers the first interest payments on any of those loans as the hedged forecasted transactions when they occur. This method of designation allows Entity C to fulfill its forecasted transactions across a broader population of loans if any variable-rate loans experience a prepayment, are sold, or experience a change in its expected cash flows related to credit difficulties.

815-20-55-99C If Entity C elects to assess similar risk exposure for the group of forecasted transactions using the method outlined in paragraph 815-20-55-23A(a) and determines that the similar risk exposure requirement is met, then Entity C also may reasonably conclude that the hedging relationship is expected to be highly effective at hedge inception if it documents the method described in paragraph 815-20-55-23A(a) as its method for assessing hedge effectiveness. Entity C should consider the differences between hedged risks of the individual forecasted transactions in the group and the contractual terms of the hedging instrument when performing those assessments. Those differences include, for example, interest rates, payment dates, reset dates, and interest rate floors.

815-20-55-99D Alternatively, if Entity C elects to assess similar risk exposure for the group of forecasted transactions using the method in paragraph 815-20-55-23A(b) and determines that the similar risk exposure requirement is met, then Entity C should perform a separate assessment to conclude that the hedging relationship is expected to be highly effective at hedge inception. Entity C should use the concepts underlying assessments of hedge effectiveness, such as the hypothetical derivative method and regression analysis, when assessing whether each hedged risk is similar to each other risk in the group. Entity C should consider the differences between the respective hedged risks of the individual forecasted transactions in the group when performing that assessment. Those differences include, for example, interest rates, payment dates, reset dates, and interest rate floors.

815-20-55-99E If Entity C determines as part of its ongoing assessments that one or more hedged risks related to individual forecasted transactions in the group are no longer similar, Entity C should dedesignate the hedging relationship as of the last date when all hedged risks in the group were assessed to have similar risk exposure, unless Entity C can determine the specific date that all hedged risks in the group were no longer similar. However, the determination that one or more hedged risks in the group are no longer similar does not affect Entity C's probability assessment related to the hedged forecasted transactions performed in accordance with paragraphs 815-30-40-4 through 40-6.

Amendments to Subtopic 815-30

5. Amend paragraphs 815-30-55-147 through 55-148, with a link to transition paragraph 815-20-65-7, as follows:

Derivatives and Hedging—Cash Flow Hedges

Implementation Guidance and Illustrations

> Illustrations

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

815-30-55-147 Because Entity Q determined that it will purchase at least 80,000 pounds of plastic each month in the coming 12 months to fulfill its expected manufacturing requirements, it documents that the hedged item (that is, the **forecasted transaction** within each month) is probable of occurring. Entity Q designates each forward contract as a cash flow hedge of the variability in cash flows attributable to changes in the ~~contractually specified~~ explicitly referenced JP index on the first 80,000 pounds of plastic purchased (regardless of grade or plant location delivered to) for the appropriate month. ~~The individual purchases of differing grades of plastic by Plant A and Plant B during each month share the risk exposure to the variability in the purchase price of the plastic attributable to changes in the contractually specified JP index. Therefore, the individual transactions in the hedged portfolio of plastic purchases for each month share the same risk exposure for which they are designated as being hedged in accordance with paragraph 815-20-25-15(a)(2).~~ **[For convenience, this paragraph also contains the amendments from Issue 3.]**

815-30-55-148 In accordance with paragraph 815-20-25-3(b)(2)(iv)(01)(B), if Entity Q has determined that the critical terms of the hedged item and hedging instrument match, it may elect to assess effectiveness qualitatively both at inception of the hedging relationship and on an ongoing basis on the basis of the following factors in accordance with paragraphs 815-20-25-84 through 25-85:

a. The hedging instrument's underlying matches the index upon which plastic purchases will be determined (that is, the JP index ~~Index~~).
b. The notional of the hedging instrument matches the forecasted quantity designated as the hedged item.
c. The date on which the derivatives mature matches the timing in which the forecasted purchases are expected to be made. That is, the quantity of the hedged item~~, 80,000 pounds,~~ (80,000 pounds) is an aggregate amount expected to be purchased over the course of the respective month (that is, the same 31-day period) in which the derivative matures.

d. Each hedging instrument was traded with at-market terms (that is, it has an initial fair value of zero).
e. Assessment of effectiveness will be performed on the basis of the total change in the fair value of the hedging instrument.
f. Although the amount of plastic being hedged each period is a cumulative amount across multiple grades of plastic, the basis differentials between grades of plastic and location are not required to be included in assessments of effectiveness because Entity Q has designated the variability in cash flows attributable to changes in the JP index ~~(the contractually specified component)~~ (the explicitly referenced variable component of the forecasted purchase price) as the hedged risk ~~within its purchases of plastics~~.

In accordance with paragraph 815-20-55-23B, if Entity Q assesses hedge effectiveness in accordance with paragraphs 815-20-25-84 through 25-85 and applies the similar risk assessment method described in paragraph 815-20-55-23A(a), it also may assume that the hedged risks related to the group of forecasted transactions are similar. **[For convenience, this paragraph also contains the amendments from Issue 3.]**

Issue 2: Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments

Amendments to Subtopic 815-20

6. Amend paragraphs 815-20-25-3(b)(2)(iii) and (d)(1)(viii), 815-20-25-79, and 815-20-55-56 and add paragraph 815-20-25-79B, with a link to transition paragraph 815-20-65-7, 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:

b. Documentation requirement applicable to fair value hedges, cash flow hedges, and net investment hedges:
   2. The entity's risk management objective and strategy for undertaking the hedge, including identification of all of the following:
      iii. The nature of the risk being hedged (also see the requirements in paragraph 815-20-25-3(d)(1)(viii)).

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:
      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 contractually specified interest rate. See paragraphs 815-30-35-37B through 35-37F for guidance on changing the contractually specified interest rate for a hedge of forecasted interest payments on an existing variable-rate debt instrument that permits the borrower to select at each reset period the interest rate index from a list of contractual options (including the tenor of the interest rate, if applicable) upon which interest is accrued (this debt instrument is referred to throughout Topic 815 as "choose-your-rate" debt).

> 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**.

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. See paragraphs 815-30-35-37E through 35-37F for guidance on the retrospective effectiveness assessment for a cash flow hedge within the scope of paragraph 815-30-35-37B related to choose-your-rate debt.

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).

815-20-25-79B For a cash flow hedge of forecasted interest payments on an existing choose-your-rate debt instrument in which the terms of the debt instrument permit the interest rate index (and interest rate tenor, if applicable) to be changed in accordance with paragraph 815-30-35-37B, the quantitative prospective assessment of hedge effectiveness shall consider all reasonably possible changes in cash flows of the forecasted transaction attributable to only the then-designated contractually specified interest rate. An entity shall not consider possible changes in cash flows of the forecasted transaction attributable to a contractually specified interest rate that may be designated in the future. 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).

Implementation Guidance and Illustrations

> Implementation Guidance

• > 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 and the method of assessing similar risk exposure), 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 815-30-35-37A,~~ paragraphs 815-30-35-37B and 815-30-35-37D, for a cash flow hedge of forecasted interest payments on choose-your-rate debt (and replacements thereof), a change ~~to the hedged risk in a cash flow hedge of a forecasted transaction~~ in the contractually specified interest rate (and associated change in the number and timing of forecasted interest payments within the hedged period, if any) does not result in an automatic dedesignation of the hedging relationship if the conditions in those paragraphs are met ~~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 represent 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. **[For convenience, this paragraph also contains the amendments from Issue 1.]**

Amendments to Subtopic 815-30

7. Amend paragraph 815-30-35-8, the heading preceding paragraph 815-30-35-37A, and paragraphs 815-30-55-54 through 55-58 and 815-30-55-60 through 55-61, supersede paragraph 815-30-35-37A, and add paragraphs 815-30-35-37B through 35-37F and 815-30-55-165 through 55-178 and their related headings, with a link to transition paragraph 815-20-65-7, as follows:

Derivatives and Hedging—Cash Flow Hedges

Subsequent Measurement

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

815-30-35-8 The remainder of this guidance addresses the following matters:

a. Application to single cash flow hedge of a forecasted sale or purchase on credit for foreign exchange risk
b. Assessing hedge effectiveness in certain cash flow hedges involving **interest rate risk** when effectiveness is assessed on a quantitative basis
c. Hedging relationship in which hedge effectiveness is based on an option's terminal value ~~value.~~
d. Change in the contractually specified interest rate for forecasted interest payments on choose-your-rate debt ~~designated hedged risk~~.

• > Change in the Contractually Specified Interest Rate for Forecasted Interest Payments on Choose-Your-Rate Debt ~~Designated Hedged Risk~~

815-30-35-37A Paragraph superseded by Accounting Standards Update No. 202X-XX. ~~If the designated hedged risk changes during the life of a hedging relationship, an entity may continue to apply hedge accounting if the hedging instrument is highly effective at achieving offsetting cash flows attributable to the revised hedged risk. The guidance in paragraph 815-20-55-56 does not apply to changes in the hedged risk for a cash flow hedge of a forecasted transaction.~~

815-30-35-37B In a cash flow hedge of forecasted interest payments that meets all of the conditions in paragraph 815-30-35-37C, the designated contractually specified interest rate (and the tenor of that rate, if applicable) is the then-selected interest rate index (and interest rate tenor, if applicable) over the life of the hedging relationship. The selection of an interest rate index or interest rate tenor in a subsequent period that alters the number and timing of the hedged forecasted interest payments within the hedge period shall not result in an automatic dedesignation of the hedging relationship.

815-30-35-37C An entity shall apply the guidance in paragraph 815-30-35-37B if all of the following conditions are satisfied:

a. At hedge inception, the forecasted interest payments designated as being hedged relate to an existing choose-your-rate debt instrument accounted for as a liability (see paragraph 815-30-35-37D for further guidance on replacement debt).
b. The maturity date of the existing choose-your-rate debt instrument described in (a) is on or after the end of the hedge period.
c. The entity designates the hedged risk as the variability in cash flows attributable to changes in a contractually specified interest rate.

The guidance in paragraph 815-30-35-37B shall not be applied by analogy to any other circumstances, including to the forecasted issuance of debt not considered replacement debt in accordance with paragraph 815-30-35-37D.

815-30-35-37D An entity may designate the forecasted interest payments in a manner that includes replacement debt. If the contractually specified interest rate upon which interest is accruing matches one of the interest rate index and interest rate tenor options included in the choose-your-rate debt instrument at hedge inception, the forecasted interest payments on replacement debt shall be considered the hedged forecasted transactions, without dedesignating the hedging relationship. If the interest rate index and interest rate tenor at which interest is accruing on the replacement debt does not match one of the interest rate index and interest rate tenor options included in the choose-your-rate debt instrument at hedge inception, the entity shall discontinue the application of

hedge accounting and immediately reclassify the gain or loss on the hedging instrument reported in accumulated other comprehensive income into earnings in accordance with paragraph 815-30-40-5. The entity also shall consider whether it has demonstrated a pattern of determining that hedged forecasted transactions are probable of not occurring and the propriety of using hedge accounting in the future for similar forecasted transactions in accordance with paragraph 815-30-40-5. Replacement debt may be a choose-your-rate debt instrument or a debt instrument with a single contractually stipulated interest rate.

815-30-35-37E If the contractually specified interest rate in the hedging relationship is changed in accordance with paragraph 815-30-35-37B, the entity shall perform a final retrospective assessment of hedge effectiveness on the basis of changes in cash flows attributable to the previous contractually specified interest rate for the last period in which interest was accruing at that interest rate. If the entity concludes on the basis of that retrospective assessment that the hedging relationship was not highly effective in having achieved offsetting cash flows, hedge accounting may not be applied during that period (that is, the overall change in the fair value of the derivative instrument for that period is recognized in earnings). However, the hedging relationship may continue if there is an expectation that the relationship will be highly effective in achieving offsetting cash flows in future periods and all other hedge accounting requirements are met. The entity shall begin prospectively assessing hedge effectiveness on the basis of changes in cash flows attributable to the new contractually specified interest rate in the period in which interest begins accruing at that newly selected interest rate.

815-30-35-37F In performing a prospective assessment with a new contractually specified interest rate, the entity shall create the terms of the instrument used to estimate changes in the cash flows attributable to the new contractually specified interest rate (under the originally designated method, for example, 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 if the new contractually specified interest rate had been designated for the entire hedge period. All subsequent retrospective and prospective assessments of hedge effectiveness shall continue to be performed on the basis of only the then-selected interest rate. With respect to the timing, an entity shall perform its assessments of effectiveness in a manner consistent with paragraph 815-20-25-3(b)(2)(iv)(02).

Implementation Guidance and Illustrations

> Illustrations

• > 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 fixed-rate 90-day notes over the next 5 years as each outstanding note matures. Entity MNO designates the variability in coupon payments attributable to changes in the SOFR OIS benchmark interest rate as the hedged risk in the cash flow hedge of the forecasted issuance of the series of $5 million notes with 90-day terms. ~~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 based on the average of Daily SOFR over the past 90 days (that is, the variable-rate interest payments are indexed to 90-Day Average SOFR, in arrears) ~~immediately following each payment~~. Entity MNO pays a fixed rate of interest (3 ~~6.5~~ percent) and receives interest at 90-Day Average SOFR, in arrears ~~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 benchmark ~~contractually specified~~ interest rate (that is, the SOFR OIS ~~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~~ monthly interest payments were directly linked to Entity B's existing SOFR-indexed ~~LIBOR-indexed~~ floating-rate assets. When those existing assets are later prepaid or sold, the future ~~quarterly~~ monthly 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~~ monthly 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~~ monthly 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 fixed-rate 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 for the remainder of the hedge period, 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 90-Day Average SOFR ~~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 ~~different~~ contractually specified interest rate of 3-Month Term SOFR ~~(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 90-Day Average SOFR, in arrears ~~LIBOR~~) with changes in the cash flows ~~value~~ of the hedged item based on the ~~revised~~ contractually specified interest rate of 3-Month Term SOFR. 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 90-Day Average SOFR, in arrears ~~LIBOR~~) is highly effective at achieving offsetting cash flows attributable to the ~~revised~~ contractually specified interest rate of 3-Month Term SOFR.

815-30-55-61 If the revised hedging relationship is not determined to be highly effective, the hedging relationship must be discontinued. 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 of 3-Month Term SOFR instead of the SOFR OIS interest rate designated in relation to the series of notes forecasted to be issued with 90-day terms ~~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 28: Hedges of Forecasted Interest Payments on Choose-Your-Rate Debt

815-30-55-165 This Example illustrates the application of the guidance in paragraphs 815-30-35-37B through 35-37F in which the designated hedged risk is the variability in cash flows attributable to changes in the contractually specified interest rate on an existing choose-your-rate debt instrument (and any replacement thereof).

815-30-55-166 On January 1, 20X1, Entity A enters into a debt arrangement with a bank for a 5-year, $20 million variable-rate note payable with the principal due at maturity. The frequency and timing of interest payments and interest rate resets are based on the then-selected variable interest rate. The note payable allows Entity A to pay interest at any of the following variable interest rates based on the rate that the entity selects at each reset date:

a. 1-Month Term SOFR (paid every 30 days)
b. 3-Month Term SOFR (paid every 90 days)
c. 6-Month Term SOFR (paid every 6 months)
d. 1-Month U.S. Treasury Rate (paid every 30 days)
e. Prime (paid every 30 days).

815-30-55-167 On January 1, 20X1, Entity A chooses to pay interest based on 1-Month Term SOFR with the rate resetting immediately following each payment due date. Entity A wishes to hedge the cash flow variability attributable to changes in the contractually specified interest rate on this choose-your-rate debt instrument. Accordingly, on January 1, 20X1, Entity A enters into a receive-variable, pay-fixed, 5-year, $20 million notional interest rate swap that requires settlement and resets every 30 days. Under the terms of the swap, Entity A receives variable payments every 30 days based on the average of Daily SOFR over the past 30 days (that is, the variable-rate interest payments are indexed to 30-Day Average SOFR, in arrears) and pays a fixed rate of 5 percent. On January 1, 20X1, the fair value of the interest rate swap is zero.

815-30-55-168 On January 1, 20X1, Entity A designates the swap as hedging the variability in cash flows attributable to changes in the contractually specified interest rate on the 5-year, $20 million notional choose-your-rate debt instrument and any replacement thereof, in accordance with paragraph 815-30-35-37B. Pursuant to this designation, the initial contractually specified interest rate is 1-Month Term SOFR. In the future, if Entity A selects an alternative interest rate index or interest rate tenor on the choose-your-rate debt instrument, the designated contractually specified interest rate would be the interest rate index and interest rate tenor selected at that time. Similarly, if Entity A replaces the choose-your-rate debt instrument with a debt instrument for which the interest rate index and interest rate tenor match one of the interest rate index and interest rate tenor options included in the choose-your-rate debt instrument at hedge inception, interest payments on the replacement debt would continue to be considered the forecasted transactions designated at hedge inception.

815-30-55-169 The replacement debt instrument does not need to be choose-your-rate debt for interest payments on the replacement debt to continue to be considered the forecasted transactions designated at hedge inception. That is, the replacement debt may have a single contractual rate or a list of possible contractual interest rate indexes and interest rate tenors from which the borrower may select. In either circumstance, if the interest rate index and interest rate tenor at which the replacement debt instrument is accruing interest match one of the interest rate index and interest rate tenor options included in the choose-your-rate debt instrument at hedge inception, interest payments on the replacement debt will continue to be considered the forecasted transactions designated at hedge inception. However, if the replacement debt includes interest rate indexes or interest rate tenors not included in the terms of the

original debt instrument and Entity A selects one of those interest rate indexes or interest rate tenors, the interest payments should not be considered the forecasted transactions designated at hedge inception. In that instance, the entity should discontinue the application of hedge accounting and immediately reclassify the gain or loss on the hedging instrument reported in accumulated other comprehensive income into earnings in accordance with paragraph 815-30-40-5. The entity also should consider whether it has demonstrated a pattern of determining that hedged forecasted transactions are probable of not occurring and the propriety of using hedge accounting in the future for similar forecasted transactions in accordance with paragraph 815-30-40-5.

815-30-55-170 Entity A performs an initial quantitative hedge effectiveness assessment on January 1, 20X1, based on the initially selected interest rate index and interest rate tenor on the hedged debt instrument (that is, 60 monthly interest payments based on 1-Month Term SOFR, with the rate resetting immediately following each payment) and concludes that the relationship is highly effective. In all subsequent quarterly periods, Entity A performs a prospective and retrospective hedge effectiveness assessment based on the then-selected interest rate index and interest rate tenor of the debt instrument. In accordance with paragraph 815-20-25-79B, this effectiveness assessment does not consider the optionality embedded within the choose-your-rate debt instrument. That is, the terms used to estimate changes in the hedged forecasted cash flows for purposes of the hedge effectiveness assessment only consider the currently selected interest rate index and interest rate tenor of 1-Month Term SOFR.

815-30-55-171 Subsequent elections to change the interest rate index and interest rate tenor on the choose-your-rate debt instrument or replacement debt instrument may affect ongoing hedge accounting for this relationship. Consider the following scenarios, each occurring on January 1, 20X4:

a. Entity A changes the variable interest rate on the choose-your-rate debt instrument to 3-Month Term SOFR, payable every 90 days, with the rate resetting immediately following each payment (Scenario A).
b. Entity A changes the variable interest rate on the choose-your-rate debt instrument to Prime, payable every 30 days, with the rate resetting immediately following each payment (Scenario B).
c. Entity A replaces the choose-your-rate debt instrument with a 3-year, $30 million 3-Month Term SOFR note, payable every 90 days, with the rate resetting immediately following each payment, with the principal due at maturity (Scenario C).
d. Entity A replaces the choose-your-rate debt instrument with a 2-year, $20 million 12-Month Term SOFR note, payable annually, with the rate

resetting immediately following each payment, with the principal due at maturity (Scenario D).

• • > Scenario A

815-30-55-172 On January 1, 20X4, Entity A elects to make future interest payments on the existing choose-your-rate debt instrument based on 3-Month Term SOFR. Consistent with Entity A's hedge documentation, this election automatically changes the contractually specified interest rate in the hedging relationship from 1-Month Term SOFR to 3-Month Term SOFR. The resulting change in the number and frequency of hedged interest payments in the hedging relationship does not result in a mandatory hedge dedesignation or require Entity A to consider the guidance in paragraphs 815-30-40-4 through 40-6 as long as the forecasted interest payments related to the hedge period are still expected to occur.

815-30-55-173 Entity A performs a final retrospective assessment of hedge effectiveness on the basis of changes in cash flows on 1-Month Term SOFR interest payments (payable every 30 days), assuming that the contractually specified interest rate will not change, and determines that the hedging relationship was highly effective through January 1, 20X4. Entity A then performs a prospective assessment of hedge effectiveness on the basis of changes in cash flows on 3-Month Term SOFR interest payments (payable every 90 days). When assessing hedge effectiveness with the new risk, Entity A creates the terms of the instrument used to estimate the changes in the cash flows of the 3-Month Term SOFR interest payments on the basis of market data as of January 1, 20X1, as required by paragraphs 815-30-35-37E through 35-37F. In performing this assessment, Entity A assumes that 3-Month Term SOFR was and will continue to be the contractually specified interest rate designated in the hedging relationship. Entity A determines that the revised hedging relationship is expected to continue to be highly effective at achieving offsetting cash flows attributable to 3-Month Term SOFR on a prospective basis and continues to apply hedge accounting.

• • > Scenario B

815-30-55-174 On January 1, 20X4, Entity A elects to make future interest payments on the existing choose-your-rate debt instrument based on Prime, payable every 30 days, with the rate resetting immediately following each payment. Consistent with Entity A's hedge documentation, this election automatically changes the contractually specified interest rate in the hedging relationship from 1-Month Term SOFR to Prime (30-day reset).

815-30-55-175 Entity A performs a final retrospective assessment of hedge effectiveness on the basis of changes in cash flows on 1-Month Term SOFR interest payments (payable every 30 days), assuming that the contractually specified interest rate will not change, and determines that the hedging relationship was highly effective through January 1, 20X4. Entity A then performs a prospective assessment of hedge effectiveness on the basis of changes in cash flows on Prime interest payments (payable every 30 days). When assessing hedge effectiveness with the new risk, Entity A creates the terms of the instrument used to estimate the changes in the cash flows of the Prime interest payments on the basis of market data as of January 1, 20X1, as required by paragraphs 815-30-35-37E through 35-37F. In performing this assessment, Entity A assumes that 30-day Prime was and will continue to be the contractually specified interest rate in the hedging relationship. Entity A determines that the revised hedging relationship is not expected to be highly effective at achieving offsetting cash flows attributable to 30-day Prime on a prospective basis. As a result, Entity A discontinues hedge accounting but continues to report the previously recognized derivative gain or loss on the hedging instrument in accumulated other comprehensive income until the forecasted interest payments affect earnings or it is deemed probable that the forecasted interest payments will not occur.

• • > Scenario C

815-30-55-176 On January 1, 20X4, Entity A replaces the choose-your-rate debt instrument with a 3-year, $30 million 3-Month Term SOFR note, payable every 90 days. Although the choose-your-rate debt instrument was repaid, forecasted interest payments on the replacement debt instrument will be used to fulfill the forecasted transactions in accordance with paragraph 815-30-35-37D because the interest rate specified in the replacement debt (3-Month Term SOFR) was an interest rate index and interest rate tenor option included in the choose-your-rate debt instrument. The fact that the principal of the replacement debt exceeds the principal hedged and that the replacement debt matures after the last hedged forecasted interest payment is expected to occur does not preclude Entity A from considering that new debt instrument to be replacement debt for purposes of that hedging relationship. Consistent with Entity A's hedge documentation, replacing the hedged debt instrument automatically changes the contractually specified interest rate designated in the hedging relationship from 1-Month Term SOFR to 3-Month Term SOFR. Furthermore, Entity A considers the guidance in paragraphs 815-30-40-4 through 40-6 and concludes that amounts should continue to be reported in accumulated other comprehensive income as long as the forecasted interest payments related to the hedge period are still expected to occur.

815-30-55-177 Entity A performs a final retrospective assessment of hedge effectiveness on the basis of changes in cash flows on 1-Month Term SOFR (payable every 30 days), assuming that the contractually specified interest rate will not change and determines that the hedging relationship was highly effective through January 1, 20X4. Entity A then performs a prospective assessment of hedge effectiveness on the basis of changes in cash flows on 3-Month Term SOFR interest payments (payable every 90 days). When assessing hedge effectiveness with the new risk, Entity A creates the terms of the instrument used to estimate the changes in the cash flows of the 3-Month Term SOFR interest payments on the basis of market data as of January 1, 20X1, as required by paragraphs 815-30-35-37E through 35-37F. In performing this assessment, Entity A assumes that 3-Month Term SOFR was and will continue to be the contractually specified interest rate designated in the hedging relationship. Entity A determines that the revised hedging relationship is expected to continue to be highly effective at achieving offsetting cash flows attributable to 3-Month Term SOFR on a prospective basis and continues to apply hedge accounting.

• • > Scenario D

815-30-55-178 On January 1, 20X4, Entity A replaces the choose-your-rate debt instrument with a 2-year, $20 million 12-Month Term SOFR note, payable every 360 days. Because 12-Month Term SOFR was not listed as one of the interest rate index and interest rate tenor options included in the choose-your-rate debt instrument at hedge inception, interest payments on this 12-Month Term SOFR note are not eligible to be designated as hedged forecasted transactions. Entity A must dedesignate the hedging relationship and immediately reclassify amounts previously recognized in accumulated other comprehensive income into earnings in accordance with paragraph 815-30-40-5. Entity A also should consider whether it has demonstrated a pattern of determining that hedged forecasted transactions are probable of not occurring and the propriety of using hedge accounting in the future for similar forecasted transactions in accordance with paragraph 815-30-40-5.

Issue 3: Cash Flow Hedges of Nonfinancial Forecasted Transactions

Amendments to Subtopic 815-20

8. Amend paragraphs 815-20-25-3(d)(1)(vii), 815-20-25-15(e), 815-20-25-15(i)(3), the heading preceding paragraph 815-20-25-22A, 815-20-25-46B, 815-20-25-77, and 815-20-25-84, supersede paragraphs 815-20-25-22A

through 25-22B, and add paragraph 815-20-25-22C, with a link to transition paragraph 815-20-65-7, 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:
      vii. If the hedged risk is the variability in cash flows attributable to changes in a ~~**contractually specified component**~~ component of the price of a nonfinancial asset (or a subcomponent as described in paragraph 815-20-25-22C(b)(2)) in a forecasted purchase or sale of a nonfinancial asset that meets the criterion in paragraph 815-20-25-15(i)(3), identification of the ~~contractually specified~~ component (or subcomponent).

> 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:

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. For example, if the forecasted transaction relates to the purchase or sale of a nonfinancial item under a contract that is required to be accounted for as a derivative under Topic 815 (that is, a recognized asset or liability), hedge accounting is permitted for a variable price component (or subcomponent) in the contract if all other hedge criteria are satisfied.

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:

3. The risk of ~~variability~~ changes in cash flows relating to a variable component (or subcomponent) of the purchase or sales price of a nonfinancial asset that meets the criteria in paragraph 815-20-25-22C. ~~attributable to changes in a **contractually specified component**. (See additional criteria in paragraphs 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.)~~

• • > Eligibility Criteria for Designating the Variability in Cash Flows Attributable to Changes in a ~~Contractually Specified~~ Component (or Subcomponent) of ~~for~~ the Purchase Price or ~~Sale~~ Sales Price of a Nonfinancial Asset as the Hedged Risk

815-20-25-22A Paragraph superseded by Accounting Standards Update No. 202X-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. 202X-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 An entity may designate the variability in cash flows attributable to changes in a component (or subcomponent) of the forecasted purchase price or sales price of a nonfinancial asset as the hedged risk in a cash flow hedge as follows:

a. If the purchase price or sales price of the nonfinancial asset is not determined pursuant to a pricing formula in an agreement, the hedged variable component is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the nonfinancial asset being purchased or sold.
b. If the purchase price or sales price of the nonfinancial asset is determined pursuant to a pricing formula in an agreement, the hedged variable component is either:
   1. Explicitly referenced in the agreement's pricing formula and clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the nonfinancial asset being purchased or sold
   2. Clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to a variable component that meets the conditions in (b)(1) (that is, a "subcomponent"). (Throughout Subtopic 815-20, reference to a subcomponent refers only to the designation guidance in this subparagraph.)

> Eligibility of Hedging Instruments

• > Intra-entity Derivatives

815-20-25-46A There is no requirement in this Subtopic that the operating unit with the interest rate, market price, or credit risk exposure be a party to the hedging instrument. Thus, for example, a parent entity's central treasury function can enter into a derivative instrument with a third party and designate it as the hedging instrument in a hedge of a subsidiary's interest rate risk for purposes of the consolidated financial statements. However, if the subsidiary wishes to qualify for hedge accounting of the interest rate exposure in its separate-entity financial statements, the subsidiary (as the reporting entity) shall be a party to the hedging instrument, which can be an intra-entity derivative obtained from the central treasury function. Thus, an intra-entity derivative for interest rate risk can qualify for designation as the hedging instrument in separate-entity financial statements but not in consolidated

financial statements. (As used in this guidance, the term *subsidiary* refers only to a consolidated subsidiary. This guidance shall not be applied directly or by analogy to an equity method investee.)

815-20-25-46B An intra-entity derivative shall not be designated as the hedging instrument if the hedged risk is any of the following:

a. The risk of changes in the overall fair value or cash flows of the entire hedged item or transaction
b. The risk of changes in hedged item’s or transaction’s fair value attributable to changes in the designated benchmark interest rate or cash flows attributable to changes in the contractually specified interest rate or designated benchmark interest rate
c. The risk of changes in hedged item’s or transaction’s fair value or cash flows attributable to changes in credit risk.
d. The risk of variability in cash flows attributable to changes in a ~~contractually specified~~ component (or subcomponent) of the price to purchase or sell a nonfinancial asset that meets the conditions in paragraph 815-20-25-22C.

Similarly, a derivative instrument contract between operating units within a single legal entity shall not be designated as the hedging instrument in a hedge of those risks. Only a derivative instrument with an unrelated third party can be designated as the hedging instrument in a hedge of those risks in consolidated financial statements.

> Hedge Effectiveness

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

815-20-25-77 There would be a mismatch between the change in fair value or cash flows of the hedging instrument and the change in fair value or cash flows of the hedged item or hedged transaction in any of the following circumstances, among others:

a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction, to the extent that those bases do not move in tandem
b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in any of the following:
   1. Notional amounts
   2. Maturities
   3. Quantity

4. Location (not applicable if the hedging instrument's underlying and the designated hedged risk are the same) ~~for hedging relationships in which the variability in cash flows attributable to changes in a **contractually specified component** is designated as the hedged risk)~~
5. Delivery dates.

c. A change in the counterparty's creditworthiness.

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 the forward contract's underlying and the designated hedged risk are the same ~~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 815-20-25-22A 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.

9. Amend paragraphs 815-20-55-17, 815-20-55-19 and its related heading, 815-20-55-79P, and 815-20-55-79R, supersede paragraphs 815-20-55-26A through 55-26E and their related headings, and add paragraphs 815-20-55-18A through 55-18D, with a link to transition paragraph 815-20-65-7, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

• > Eligibility of Hedged Items

• • > Hedged Items in Cash Flows Hedges Only

815-20-55-17 This guidance on hedged items in cash flow hedges only is organized as follows:

a. Exposure to variability in cash flows
b. Variable price component (or subcomponent) of a ~~purchase contract~~ forecasted transaction to purchase or sell a nonfinancial asset as hedged risk ~~item~~
c. Grouping individual transactions
d. Probability of a **forecasted transaction**
e. Specificity of timing of a forecasted transaction
ee. Subparagraph superseded by Accounting Standards Update No. 202X-XX.~~Determining if a contractually specified component exists~~
eee. Subparagraph superseded by Accounting Standards Update No. 202X-XX.~~Contractually specified component in a not-yet-existing contract~~
f. Forecasted acquisition of a marketable debt security
g. Stock-appreciation-right obligation as a hedged item
h. First-payments-received technique in hedging variable ~~nonbenchmark~~ interest payments on a group of loans.

• • • > Exposure to Variability in Cash Flows

815-20-55-18 The future sale of an asset or settlement of a liability that exposes an entity (consistent with the criterion in paragraph 815-20-25-15(c)(2)) to the risk of a change in fair value may result in recognizing a gain or loss in earnings when the sale or settlement occurs. Changes in market price could change the amount for which the asset or liability could be sold or settled and, consequently, change the amount of gain or loss recognized. **Forecasted transactions** that expose an entity to cash flow risk have the potential to affect reported earnings because the amount of related revenue or expense may differ depending on the price eventually paid or received. Thus, an entity could designate the forecasted sale of a product at the market price at the date of sale as a hedged transaction because revenue will be recorded at that future sales price.

• • • > Variable Price Component (or Subcomponent) of a ~~Purchase Contract~~ Forecasted Transaction to Purchase or Sell a Nonfinancial Asset as Hedged Risk ~~Item~~

815-20-55-18A This guidance discusses the implementation of paragraphs 815-20-25-15(i)(3) and 815-20-25-22C.

815-20-55-18B An entity may designate the variability in cash flows attributable to changes in a component (or subcomponent) of the forecasted purchase price or sales price of a nonfinancial asset as the hedged risk in a cash flow hedge if the conditions in paragraph 815-20-25-22C are satisfied. The scope of that paragraph includes forecasted transactions to purchase or sell nonfinancial assets consummated in spot markets and pursuant to arrangements to purchase or sell nonfinancial assets in the future.

815-20-55-18C To be eligible to designate a hedge of a variable component of a forecasted purchase price or sales price of a nonfinancial asset in the spot market, paragraph 815-20-25-22C(a) requires that the component being designated as the hedged risk be clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the nonfinancial asset being purchased or sold. If an entity wants to designate a hedge of a variable component of a forecasted purchase or sales price of a nonfinancial asset to be consummated pursuant to a variable price contract, paragraph 815-20-25-22C(b)(1) requires that the component being hedged be both clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the nonfinancial asset being purchased or sold and explicitly referenced in the agreement's pricing formula used to determine that purchase or sales price. Alternatively, if an entity wants to hedge a subcomponent of an explicitly referenced component in an agreement's pricing formula, paragraph 815-20-25-22C(b)(2) requires that the subcomponent be clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to that explicitly referenced component and that the explicitly referenced component is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the nonfinancial asset.

815-20-55-18D If an entity enters into an agreement to purchase or sell a nonfinancial asset that meets the definition of a derivative and the entity applies the normal purchases and normal sales scope exception in Subtopic 815-10, the condition in paragraph 815-20-25-22C(b)(1) is met for the variable pricing component that is explicitly referenced in the agreement. Entities that do not apply the normal purchases and normal sales scope exception in Subtopic 815-10 and account for an agreement to purchase or sell a nonfinancial asset as a derivative may, as permitted by paragraph 815-20-25-15(e), designate a variable component (or subcomponent) of the forecasted purchase price or sales price as the hedged risk as discussed in paragraph 815-20-55-18C.

815-20-55-19 This guidance discusses several hedge designation methods that an entity may use when hedging the purchase of a nonfinancial asset ~~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 attributable to the hedged risk in a cash flow hedge of its forecasted purchases under the contract. In accordance with paragraph ~~815-20-25-15(i)~~ 815-20-25-15(i)(2), 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~~ In accordance with paragraph 815-20-25-15(i)(3), the entity also may designate the variability in cash flows attributable to changes in a ~~the contractually specified~~ component (or subcomponent) of the purchase price of the nonfinancial asset ~~(VWX sugar index)~~ as the hedged risk. ~~In that case, the entity not only must consider whether~~ In this Example, the entity could designate as the hedged risk the variable basis differential related to transportation costs or the VWX sugar index, both of which are variable components ~~is~~ explicitly referenced in the purchase ~~agreement~~ agreement. The entity also could designate a subcomponent of either transportation costs or the VWX sugar index as the hedged risk. If designating a subcomponent, the entity ~~but also~~ must ensure that the ~~requirements~~ conditions in paragraph ~~815-20-25-22A~~ 815-20-25-22C(b) are met. In ~~both~~ all 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. 202X-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. 202X-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.~~

815-20-55-26C Paragraph superseded by Accounting Standards Update No. 202X-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.~~

815-20-55-26D Paragraph superseded by Accounting Standards Update No. 202X-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.~~

815-20-55-26E Paragraph superseded by Accounting Standards Update No. 202X-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.~~

• > Hedge Effectiveness

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

815-20-55-79O The following scenarios illustrate the application of paragraphs 815-20-35-2A through 35-2F.

• • • > 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~~ met, including the ~~requirements of~~ relevant conditions in paragraph 815-20-25-22C~~ 815-20-25-22A will be met in the contract once executed in accordance with paragraph 815-20-25-22B. Entity B also will assess whether the criteria in 815-20-25-22A are met in the contract when it is executed~~.

815-20-55-79Q Because the hedged risk and forward contract are based on different indexes, the hedging relationship does not qualify for one of the exemptions in paragraph 815-20-25-3(b)(2)(iv)(01). Entity B performs an initial quantitative hedge effectiveness assessment and determines that the hedging instrument is highly effective at achieving offsetting cash flows associated with the hedged item attributable to the hedged risk. In Entity B's hedge documentation, it elects to perform subsequent assessments of hedge effectiveness on a qualitative basis. It makes this election based on the following factors:

a. The results of the quantitative effectiveness assessment performed at hedge inception indicate that the hedging relationship is close to achieving perfect offset.
b. Changes in the value of the cottonseed meal index have been consistently highly correlated with changes in value of the soybean meal index such that expected changes in market conditions are not anticipated to prevent the hedging relationship from achieving highly effective offset.
c. Although the underlyings of the hedging instrument and hedged item do not match, the notional amount of the derivative and the expected quantity to be purchased do match. Based on the quantitative effectiveness assessment, Entity B also determined that the difference in timing between the maturity date of the derivative and the dates on which the group of forecasted purchases is expected to occur is insignificant.

815-20-55-79R During the fourth quarter of 20X1, a storm damages the soybean harvest, which leads to a shortage in soybean meal supply and a sharp increase in the price of soybean meal based on the soybean meal index. The cottonseed meal index has not experienced a similar increase because cotton harvests were unaffected by the storm that damaged the soybean harvest. Because the increase in the soybean meal index is not reflected in the

cottonseed meal index, Entity B concludes that a change in facts and ~~circumstance~~ circumstances has occurred that prevents a qualitative assertion in subsequent periods that the hedging relationship continues to be highly effective at achieving offsetting cash flows. Thus, on the next subsequent effectiveness assessment date (December 31, 20X1), the company begins performing quantitative assessments of hedge effectiveness based on the method used to perform the initial prospective assessment of effectiveness. In the effectiveness assessment performed on December 31, 20X1, Entity B determines that the hedging relationship remains highly effective but that it is not close to achieving perfect offset.

815-20-55-79S Entity B returns to assessing effectiveness qualitatively as of June 30, 20X2, because the evaluation of the following criteria leads to the conclusion that high effectiveness can be asserted prospectively on a qualitative basis:

a. Entity B determines that the event that caused the soybean meal index and cottonseed meal index to experience a lack of correlation was temporary, that it was an isolated weather event, and the effect of the weather event has passed.
b. The changes in value of the soybean meal index and cottonseed meal index reverted to levels of correlation that were consistent with those before the storm.
c. The results of the June 30, 20X2 quantitative assessment of effectiveness are in line with the results of the quantitative assessment of effectiveness performed at hedge inception.
d. No further disruptions in supply are expected.

Amendments to Subtopic 815-30

10. Amend paragraphs 815-30-55-2 through 55-4, 815-30-55-21, 815-30-55-23, 815-30-55-41, 815-30-55-134 and its related heading, 815-30-55-138, and 815-30-55-146 through 55-148 and add paragraphs 815-30-55-149 through 55-164 and their related headings, with a link to transition paragraph 815-20-65-7, as follows:

Derivatives and Hedging—Cash Flow Hedges

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 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.

815-30-55-2 Entity G forecasts the purchase of 500,000 pounds of Brazilian coffee for U.S. dollars in 6 months. The agreement outlining purchase terms between Entity G and its supplier contains a ~~**contractually specified component**~~ ~~referencing a~~ pricing formula that explicitly references the Brazilian coffee index denominated in U.S. dollars. Thus, the purchase price will be based on that coffee index as of the delivery date (that is, in six months). Entity G designates the variability in cash flows related to its forecasted purchase of Brazilian coffee attributable to changes in the ~~contractually specified component (~~Brazilian coffee index ~~index)~~ as the hedged risk. Entity G determines that the Brazilian coffee index explicitly referenced in the agreement's pricing formula is clearly and closely related to the forecasted purchase of 500,000 pounds of Brazilian coffee and therefore meets the conditions in paragraph 815-20-25-22C(b)(1). Rather than acquire a **derivative instrument** based on Brazilian coffee, Entity G enters into a 6-month forward contract to purchase 500,000 pounds of Colombian coffee for U.S. dollars and designates the forward contract as a hedging instrument in a cash flow hedge of the variability in cash flows attributable to changes in the ~~contractually specified~~ explicitly referenced Brazilian coffee index component of its forecasted purchase of Brazilian coffee.

815-30-55-3 Entity G bases its assessment of hedge effectiveness on changes in forward prices, with the resulting gain or loss discounted to reflect the time value of money. Both at inception and on an ongoing basis, Entity G could assess the effectiveness of the hedge by comparing changes in the expected cash flows from the Colombian coffee forward contract with the expected net change in cash outflows attributable to changes in the ~~contractually specified component~~ price index explicitly referenced in the agreement for purchasing the Brazilian coffee for different market prices. (A simpler method that should produce the same results would consider the expected future correlation of the prices of Brazilian and Colombian coffee, based on the correlation of those prices over past six-month periods.)

815-30-55-4 In assessing hedge effectiveness on an ongoing basis, Entity G also must consider the extent of offset between the change in expected cash flows on its Colombian coffee forward contract and the expected net change in expected cash flows for the forecasted purchase of Brazilian coffee attributable to changes in the ~~contractually specified~~ designated price component (Brazilian coffee index). Both changes would be measured on a cumulative basis for actual changes in the forward price of the respective coffees during the hedge period.

815-30-55-5 See Topic 820 (including paragraph 820-10-55-13) for a discussion of expected cash flows.

815-30-55-6 Because the only difference between the forward contract and forecasted purchase relates to the type of coffee (Colombian versus Brazilian), Entity G could consider the changes in the cash flows on a forward contract for Brazilian coffee to be a measure of perfectly offsetting changes in cash flows for its forecasted purchase of Brazilian coffee. For example, for given changes in the U.S. dollar prices of six-month and three-month Brazilian and Colombian contracts, Entity G could compute the effect of a change in the price of coffee on the expected cash flows of its forward contract on Colombian coffee and of a forward contract for Brazilian coffee as follows.

	Estimate of Change in Cash Flows	
	Hedging Instrument: **Forward Contract on Colombian Coffee**	***Estimate of Forecasted Transaction:*** **Forward Contract on Brazilian Coffee**
Forward price of Colombian and Brazilian coffee:		
At hedge inception—6-month price	$ 2.54	$ 2.43
3 months later—3-month price	2.63	2.53
Cumulative change in price—gain	$ 0.09	$ 0.10
× 500,000 pounds of coffee	× 500,000	× 500,000
Estimate of change in cash flows	$ 45,000	$ 50,000

815-30-55-7 See Topic 820 (including paragraph 820-10-55-13) for a discussion of expected cash flows.

815-30-55-8 Using the amounts in paragraph 815-30-55-6, Entity G could evaluate effectiveness 3 months into the hedge on its first subsequent quarterly effectiveness assessment testing date by comparing the $45,000 change on its Colombian coffee contract with what would have been a perfectly offsetting change in cash flow for its forecasted purchase—the $50,000 change on an otherwise identical forward contract for Brazilian coffee. Entity G concludes that

the hedging relationship would be highly effective, and it would record the $45,000 change in the fair value of the forward contract on Colombian coffee in other comprehensive income.

a. Subparagraph superseded by Accounting Standards Update No. 2017-12.
b. Subparagraph superseded by Accounting Standards Update No. 2017-12.

• > Example 5: Cash Flow Hedge of the Forecasted Sale of a Commodity When the Critical Terms Match

815-30-55-20 This Example illustrates the application of the guidance in paragraphs 815-20-25-84 through 25-85 and this Subtopic to the accounting for a cash flow hedge of a forecasted sale of a commodity. The terms of the hedging derivative have been negotiated to match the terms of the forecasted transaction. Assume that there is no time value in the derivative instrument. Entity ABC has chosen to hedge the variability of the cash flows from the forecasted sale of the commodity instead of the changes in its fair value. 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.

815-30-55-21 ~~Because there is no **contractually specified component**,~~ Entity ABC hedges the risk of changes in its cash flows relating to changes in the sales price of a forecasted sale of 100,000 bushels of Commodity A by entering into a derivative instrument, Derivative Z. Entity ABC expects to sell the 100,000 bushels of Commodity A on the last day of Period 1. On the first day of Period 1, Entity ABC enters into Derivative Z and designates it as a cash flow hedge of the forecasted sale. Entity ABC neither pays nor receives a premium on Derivative Z (that is, its fair value is zero). Entity ABC expects that there will be perfect offset between the hedging instrument and the hedged item because all of the following conditions exist:

a. The notional amount of Derivative Z is 100,000 bushels and the forecasted sale is for 100,000 bushels.
b. The **underlying** of Derivative Z is the price of the same variety and grade of Commodity A that Entity ABC expects to sell (assuming delivery to Entity ABC's selling point).
c. The settlement date of Derivative Z is the last day of Period 1 and the forecasted sale is expected to occur on the last day of Period 1.

The entity need not perform an initial quantitative assessment of hedge effectiveness in accordance with paragraph 815-20-25-3(b)(2)(iv)(01) because the conditions in paragraphs 815-20-25-84 through 25-85 are met.

815-30-55-22 At inception of the hedge, the expected sales price of 100,000 bushels of Commodity A is $1,100,000. On the last day of Period 1, the fair value of Derivative Z has increased by $25,000, and the expected sales price of 100,000 bushels of Commodity A has decreased by $25,000. Both the sale of 100,000 bushels of Commodity A and the settlement of Derivative Z occur on the last day of Period 1. The following table illustrates the accounting, including the net effect on earnings and other comprehensive income, for the situation described.

	Debit (Credit)			
	Cash	Derivative	Other Comprehensive Income	Earnings[a]
Recognize change in fair value of derivative		$ 25,000	$ (25,000)	
Recognize revenue from sale	$ 1,075,000			$ (1,075,000)
Recognize settlement of derivative	25,000	(25,000)		
Reclassify change in fair value of derivative to earnings			25,000	(25,000)
Total	$ 1,100,000	$ -	$ -	$ (1,100,000)

(a) The change in fair value of the hedging derivative is presented in the same income statement line item as the earnings effect of the hedged item.

815-30-55-23 At ~~the~~ inception of the hedge, Entity ABC anticipated that it would receive $1,100,000 from the sale of 100,000 bushels of Commodity A. This Example illustrates that by hedging the risk of changes in its cash flows relating to the forecasted sale of 100,000 bushels of Commodity A, Entity ABC still received a total of $1,100,000 in cash flows even though the sales price of Commodity A declined during the period.

• > Example 8: Designation and Discontinuance of a Cash Flow Hedge of the Forecasted Purchase of Inventory

815-30-55-40 This Example illustrates the effect on earnings and other comprehensive income of discontinuing a cash flow hedge by dedesignating the hedging derivative under paragraph 815-30-40-1(c) before the variability of the cash flows from the hedged forecasted transaction has been eliminated. It also discusses the effect that the location of a physical asset has on the effectiveness of a hedging relationship. 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.

815-30-55-41 On February 3, 20X1, Entity JKL forecasts the purchase of 100,000 bushels of corn on May 20, 20X1. ~~The contract does not contain a **contractually specified component**, and~~ Entity JKL designates changes in cash flows related to the forecasted transaction attributable to all changes in the purchase price as the hedged risk. It expects to sell finished products produced from the corn on May 31, 20X1. On February 3, 20X1, Entity JKL enters into 20 futures contracts, each for the purchase of 5,000 bushels of corn on May 20, 20X1 (100,000 in total), and designates those contracts as a hedging instrument in a cash flow hedge of the forecasted purchase of corn.

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

815-30-55-134 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic for assessing effectiveness for a cash flow hedge of a forecasted purchase of inventory with a forward contract for which the hedged risk is variability in cash flows attributable to changes in ~~a~~ an explicitly referenced variable component of the purchase price of the inventory ~~**contractually specified component**~~. Assume the entity elects to perform subsequent assessments of hedge effectiveness on a quantitative basis using a cumulative-dollar-offset approach and all hedge documentation requirements were satisfied at inception.

815-30-55-135 Entity J manufactures keys for door locks on buildings and cars. The keys are cut from sheets of metal called *key plates*. Entity J primarily purchases its key plates from Supplier 1 as needed. Supplier 1 and Entity J have an outstanding agreement specifying that the per-unit cost of each key plate will be determined by Supplier 1 on the first business day of each month on the basis of the following pricing formula:

a. Spot price of COMEX Zinc per pound × 0.2 pounds, plus
b. Spot price of COMEX Copper per pound × 0.1 pounds, plus
c. The current cost of refining copper and zinc into key plates, plus
d. The current cost of transporting the key plates to Entity J.

815-30-55-136 In January 20X1, Entity J expects to purchase 100,000 key plates in July 20X1, which requires 10,000 pounds of copper for the manufacturing process. Entity J decides that it wishes to hedge only the change in value of the price of COMEX Copper used to create the key plates being purchased in July 20X1.

815-30-55-137 On January 15, 20X1, Entity J enters into a forward contract maturing on July 1, 20X1 (that is, the date on which the price of copper used to manufacture the key plates is fixed) to purchase 10,000 pounds of COMEX Copper at $2.10 per pound. Any settlement amount on the forward contract will be based on the difference between the contract price of $2.10 per pound and the spot price of COMEX Copper on the maturity date (July 1, 20X1), multiplied by the notional amount of 10,000 pounds.

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,~~ 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 are met.~~ Entity J determines that the COMEX Copper price index explicitly referenced in the agreement's pricing formula is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to key plates and concludes that the conditions in paragraph 815-20-25-22C(b)(1) are met.

815-30-55-139 Entity J bases its assessment of hedge effectiveness on cumulative changes in the fair value of the hedging instrument and the hedged item attributable to changes in the hedged risk.

815-30-55-140 In assessing hedge effectiveness on an ongoing basis, Entity J must consider the extent of offset between the change in expected cash flows on the hedging instrument (the copper forward contract) and the hedged item attributable to changes in the hedged risk (change in expected cash flows associated with forecasted purchases of key plates attributable to changes in the COMEX Copper price index). The table below illustrates the cumulative changes in the hedging instrument and hedged item attributable to changes in the hedged risk as of the first subsequent quarterly effectiveness assessment date.

	Estimate of Change in Cash Flows	
	Hedging Instrument	Hedged Item Due to Fluctuation in Hedged Risk
Forward price of copper (dollars per pound)		
At hedge inception (Jan 15, 20X1)	$ 2.10	$ 2.10
At first subsequent assessment date (March 31, 20X1)	$ 2.25	$ 2.25
Change in forward price of copper	$ 0.15	$ 0.15
Cumulative change in copper (per pound) × 10,000 pounds of copper	$ 1,500.00	$ 1,500.00

815-30-55-141 Entity J could assess effectiveness as of March 31, 20X1, by comparing the $1,500 change in the hedging instrument with the $1,500 change in the hedged item attributable to changes in the hedged risk because the hedging instrument's maturity date and the date on which the price of copper will be fixed match (that is, July 1, 20X1).

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

815-30-55-142 This Example illustrates the application of the guidance in Subtopic 815-20 and this Subtopic to the designation of a **cash flow hedge** of a forecasted purchase of inventory in which the commodity exposure is managed centrally at the aggregate level. Assume the entity elects to perform subsequent assessments of hedge effectiveness on a qualitative basis and all hedge documentation requirements were satisfied at inception.

815-30-55-143 Entity Q is seeking to hedge the variability in cash flows associated with commodity price risk of its monthly plastic purchases for the next 12 months. It has two different manufacturing plant locations (Plant A and Plant B) that are purchasing five different grades of plastic from Supplier A. The plastic purchase price for each month is based on the month-end Joint Plastic (JP) index and a fixed basis differential component. The fixed basis differential offered by the supplier is determined by:

a. The grade of the plastic purchased
b. The distance between the plant location and supplier location.

815-30-55-144 At January 1, 20X1, Entity Q enters into a supply agreement with Supplier A to purchase plastic over the next 12 months. The respective agreements allow Entity Q to purchase the various grades of plastic at both of its plant locations as the need arises over the following year. The following table summarizes the pricing provisions contained in the supply agreement for each grade of plastic.

	Grade 1	Grade 2	Grade 3	Grade 4	Grade 5
Plant A	JP + $0.14	JP + $0.11	JP + $0.09	JP + $0.05	JP – $0.02
Plant B	JP + $0.16	JP + $0.12	JP + $0.07	JP + $0.06	JP – $0.03

815-30-55-145 Entity Q's risk management objective is to hedge the variability in the purchase price of plastic attributable to changes in the JP index of the first 80,000 pounds of plastic purchased in each month regardless of grade or plant location delivered to. To accomplish this objective, Entity Q executes 12 separate forward contracts at January 1, 20X1, to purchase plastic as follows.

	Settlement Date	Notional Amount	Underlying Index
Jan forward	January 30, 20X1	80,000 (lbs)	JP
Feb forward	February 28, 20X1	80,000 (lbs)	JP
Mar forward	March 30, 20X1	80,000 (lbs)	JP
April forward	April 30, 20X1	80,000 (lbs)	JP
May forward	May 30, 20X1	80,000 (lbs)	JP
June forward	June 30, 20X1	80,000 (lbs)	JP
July forward	July 30, 20X1	80,000 (lbs)	JP
Aug forward	August 30, 20X1	80,000 (lbs)	JP
Sep forward	September 30, 20X1	80,000 (lbs)	JP
Oct forward	October 30, 20X1	80,000 (lbs)	JP
Nov forward	November 30, 20X1	80,000 (lbs)	JP
Dec forward	December 30, 20X1	80,000 (lbs)	JP

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~~ designates the variability in ~~the~~ cash flows attributable to changes in ~~a contractually specified~~ the JP index component as the hedged risk ~~in paragraph 815-20-25-22A are met~~. Entity Q determines that the JP index explicitly referenced in the supply agreement is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to plastic and concludes that the conditions in paragraph 815-20-25-22C(b)(1) are met.

815-30-55-147 Because Entity Q determined that it will purchase at least 80,000 pounds of plastic each month in the coming 12 months to fulfill its expected manufacturing requirements, it documents that the hedged item (that is, the **forecasted transaction** within each month) is probable of occurring. Entity Q designates each forward contract as a cash flow hedge of the variability in cash flows attributable to changes in the ~~contractually specified~~ explicitly referenced JP index on the first 80,000 pounds of plastic purchased (regardless of grade or plant location delivered to) for the appropriate month. ~~The individual purchases of differing grades of plastic by Plant A and Plant B during each month share the risk exposure to the variability in the purchase price of the plastic attributable to changes in the contractually specified JP index. Therefore, the individual transactions in the hedged portfolio of plastic purchases for each month share the same risk exposure for which they are designated as being hedged in accordance with paragraph 815-20-25-15(a)(2).~~ **[For convenience, this paragraph also contains the amendments from Issue 1.]**

815-30-55-148 In accordance with paragraph 815-20-25-3(b)(2)(iv)(01)(B), if Entity Q has determined that the critical terms of the hedged item and hedging instrument match, it may elect to assess effectiveness qualitatively both at inception of the hedging relationship and on an ongoing basis on the basis of the following factors in accordance with paragraphs 815-20-25-84

through 25-85:

a. The hedging instrument's underlying matches the index upon which plastic purchases will be determined (that is, the JP index ~~Index~~).
b. The notional of the hedging instrument matches the forecasted quantity designated as the hedged item.
c. The date on which the derivatives mature matches the timing in which the forecasted purchases are expected to be made. That is, the quantity of the hedged item~~, 80,000 pounds,~~ (80,000 pounds) is an aggregate amount expected to be purchased over the course of the respective month (that is, the same 31-day period) in which the derivative matures.
d. Each hedging instrument was traded with at-market terms (that is, it has an initial fair value of zero).
e. Assessment of effectiveness will be performed on the basis of the total change in the fair value of the hedging instrument.
f. Although the amount of plastic being hedged each period is a cumulative amount across multiple grades of plastic, the basis differentials between grades of plastic and location are not required to be included in assessments of effectiveness because Entity Q has designated the variability in cash flows attributable to changes in the JP index ~~(the contractually specified component)~~ (the explicitly referenced variable component of the forecasted purchase price) as the hedged risk~~ within its purchases of plastics~~.

In accordance with paragraph 815-20-55-23B, if Entity Q assesses hedge effectiveness in accordance with paragraphs 815-20-25-84 through 25-85 and applies the similar risk assessment method described in paragraph 815-20-55-23A(a), it also may assume that the hedged risks related to the group of forecasted transactions are similar. **[For convenience, this paragraph also contains the amendments from Issue 1.]**

• > Example 24: Designation of a Price Component as the Hedged Risk in a Forecasted Purchase of Nonfinancial Assets in a Cash Flow Hedge for Which Any Contractual Shortfall Is Expected to Be Purchased in the Spot Market

815-30-55-149 This Example illustrates the application of the guidance in paragraphs 815-20-25-15(e) and 815-20-25-22C to determine whether a price component is eligible to be designated as the hedged risk in a forecasted purchase of nonfinancial assets in which the associated forward contracts are accounted for as derivatives because physical settlement is not probable of occurring, but it is probable that any shortfall will be purchased in the spot market. On January 1, 20X1, Entity R enters into forward contracts with

multiple suppliers to purchase an aggregate 1,000 bushels of soybeans for delivery in June 20X1 to use in its operations. Each contract stipulates that the purchase price per bushel is equal to the ABC soybean index price (June maturity) plus a variable basis differential representing transportation costs. Furthermore, each contract permits net settlement of the contract if the quality of the soybeans delivered does not meet Entity R's specifications. If that happens, Entity R will net settle the affected forward contracts and purchase soybeans of the appropriate specifications in the spot market to make up for any shortfall. Given a history of suppliers not delivering soybeans meeting the required specifications, Entity R cannot assert that any specific forward contract will be physically settled and, therefore, determines that the forward contracts do not qualify for the normal purchases and normal sales scope exception.

815-30-55-150 On January 1, 20X1, Entity R enters into a futures contract to fix the price of 1,000 bushels of ABC soybeans pursuant to its risk management objective. Entity R designates this futures contract as a hedge of the variability in cash flows attributable to changes in the ABC soybean index (a component of the price of soybeans) related to the first 1,000 bushels of soybeans forecasted to be purchased in June 20X1. The forecasted purchases include ABC soybeans purchased from suppliers pursuant to forward contracts and ABC soybeans purchased in the spot market.

815-30-55-151 Entity R determines that the ABC soybean index is an eligible hedged risk for the forecasted purchase of 1,000 bushels of ABC soybeans for delivery in June 20X1 in either the spot market or pursuant to the supplier contracts. To reach that conclusion, Entity R performs two distinct assessments. In accordance with paragraph 815-20-25-22C(a), Entity R determines that the ABC soybean index (that is, the hedged variable component) is clearly and closely related to the nonfinancial asset being purchased (that is, ABC soybeans in the pertinent spot market). In accordance with paragraph 815-20-25-22C(b)(1), Entity R determines that the ABC soybean index (that is, the hedged variable component) is explicitly referenced in the pricing formula of the supplier contracts and that the ABC soybean index is clearly and closely related to ABC soybeans. Although Entity R is unable to assert that forward contracts with suppliers were probable of physical settlement, Entity R can assert that the forecasted transactions are probable of occurring through a combination of physically settled forward contracts and spot market transactions.

• > Example 25: Designation of a Price Subcomponent of an Explicitly Referenced Component in an Agreement as the Hedged Risk in a Cash Flow Hedge of a Forecasted Purchase of Nonfinancial Assets

815-30-55-152 This Example illustrates the application of the guidance in paragraph 815-20-25-22C to determine whether a subcomponent of a component that is explicitly referenced in an agreement can be designated as the hedged risk in a cash flow hedge of a forecasted purchase of a nonfinancial asset.

815-30-55-153 Entity X is a manufacturing company that uses copper wire (that is, copper that has been drawn down to size and processed for manufacturing purposes) in the normal course of business. On January 1, 20X1, Entity X enters into a supply agreement to purchase 1,000 pounds of copper wire for its manufacturing operations in each of the next 12 months. The supply agreement stipulates that the monthly purchase price per pound is equal to the ABC Copper Wire index price (maturing in month of delivery), plus other basis differentials. Entity X determines that the supply agreement meets the definition of a derivative in Topic 815.

815-30-55-154 Entity X is seeking to reduce its commodity price exposure to the forecasted purchase of 1,000 pounds of copper wire in each of the next 12 months. Derivatives referencing the ABC Copper Wire index are less liquid than derivatives referencing the core underlying ingredient in copper wire, which is raw copper. Entity X determines that the market for ABC Copper Wire index is based on the price of raw copper plus processing costs, that it takes one pound of raw copper to produce one pound of copper wire, and that raw copper prices are based on COMEX Copper Futures. Therefore, on January 1, 20X1, Entity X executes 12 futures contracts, each having a 1,000-pound notional amount tied to the COMEX Copper index futures price (maturing in successive months). Those derivatives are designated as hedging the risk of cash flow variability attributable to the COMEX Copper index (a subcomponent of the explicitly referenced ABC Copper Wire index) related to its forecasted purchase of the first 1,000 pounds of copper wire per month.

815-30-55-155 Entity X applies the normal purchases and normal sales scope exception in accordance with Subtopic 815-10 to the contract to purchase copper wire. Therefore, Entity X determines that the ABC Copper Wire index (the explicitly referenced component in the forward contract) is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the forecasted transaction. In addition, Entity X determines that the COMEX Copper index is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the explicitly referenced ABC Copper Wire index. Thus,

Entity X determines that the COMEX Copper index is an eligible risk subcomponent in accordance with paragraph 815-20-25-22C(b)(2).

• > Example 26: Designation of a Price Component as the Hedged Risk in a Cash Flow Hedge of a Forecasted Purchase of Nonfinancial Assets in the Spot Market

815-30-55-156 This Example illustrates the application of the guidance in paragraph 815-20-25-22C to determine whether a price component in a forecasted purchase of a nonfinancial asset in the spot market is eligible to be designated as the hedged risk.

815-30-55-157 On December 31, 20X0, Entity C forecasts that it will purchase at least 20,000 MMBtus of natural gas in the spot market for production purposes in June 20X1. On January 1, 20X1, Entity C enters into a futures contract to fix the price of 20,000 MMBtus of natural gas that is tied to the XYZ National NatGas index (June 20X1 maturity) pursuant to its risk management objective. Entity C designates the futures contract as the hedging instrument in a cash flow hedge of the variability in cash flows attributable to the XYZ National NatGas index component related to its forecasted purchase of the first 20,000 MMBtus of natural gas in the spot market in June 20X1.

815-30-55-158 Entity C concludes that agreements to purchase natural gas in this region are frequently priced using one of the following formulas:

a. ABC Regional NatGas index price + Fixed Spread
b. XYZ National NatGas index price + Cost to Transport + Fixed Spread.

Purchases of natural gas in this region are often tied to the ABC Regional NatGas index because it reflects the natural gas prices of the closest geographical proximity to an entity. Additionally, the XYZ National NatGas index is a nationally recognized index that is commonly used by market participants to price contracts throughout the country, adjusted for the cost to transport that natural gas to various hubs for sale. Entity C reasonably determines that the ABC Regional NatGas index and the XYZ National NatGas index are not extraneous to changes in the fair value of natural gas in the region of the transaction.

815-30-55-159 Entity C determines that the XYZ National NatGas index component is clearly and closely related (as described in paragraph 815-10-15-32(a) through (b)) to the forecasted purchase of natural gas in the spot market in accordance with paragraph 815-20-25-22C(a). Because the price of natural gas being purchased by Entity C is not set forth in an agreement, there is no consideration of the guidance in paragraph 815-20-25-22C(b). If Entity C

had chosen to designate the ABC Regional NatGas index as the hedged risk and determined that this index was clearly and closely related to the forecasted purchase of natural gas in the spot market, that also would be permissible under paragraph 815-20-25-22C(a).

• > Example 27: Designation of Multiple Price Components as the Hedged Risks in a Group of Forecasted Purchases of Nonfinancial Assets in a Not-Yet-Existing Contract or Contracts

815-30-55-160 This Example illustrates the application of the guidance in paragraph 815-20-25-22C to determine whether multiple price components are eligible to be designated as the hedged risks in a group of forecasted purchases of nonfinancial assets when uncertainty exists about which component or components will be explicitly referenced in the pricing formula or formulas of a not-yet-existing contract or contracts.

815-30-55-161 Entity Y's objective is to hedge the variability in cash flows attributable to changes in the explicitly referenced component or components in a not-yet-existing agreement or agreements to purchase 1,000 bushels of soybeans. On January 1, 20X1, Entity Y begins negotiations with multiple vendors to purchase 1,000 bushels of soybeans on June 30, 20X2. As of April 1, 20X1, the counterparties have not agreed on whether the pricing formula of the agreement or agreements will price the soybeans based on the ABC Soybean index or the DEF Soybean index. Entity Y concludes that it is probable that 1,000 bushels of soybeans will be purchased from various vendors and that it expects the pricing formula in the agreement or agreements to reference either the ABC Soybean index or the DEF Soybean index.

815-30-55-162 On April 1, 20X1, Entity Y enters into a futures contract for 1,000 bushels of ABC Soybeans maturing on June 30, 20X2. Entity Y designates that futures contract as a hedge of cash flow variability attributable to the designated hedged risk that will be explicitly referenced in a not-yet-existing contract or contracts for the forecasted purchase of the first 1,000 bushels of soybeans on June 30, 20X2. Because of the uncertainty of whether the not-yet-existing agreement's or agreements' pricing formula or formulas will reference the ABC Soybean index or the DEF Soybean index, Entity Y designates both indexes as the hedged risks in a cash flow hedge of the first 1,000 bushels of soybeans purchased on June 30, 20X2.

815-30-55-163 At hedge inception, Entity Y performs an assessment of similar risk and effectiveness on the basis of the explicit pricing formula or formulas it expects to be referenced in the agreement or agreements to determine whether the hedging relationship is eligible under paragraph 815-20-25-22C. Entity Y

elects to assess whether the hedged risks in the group of individual forecasted transactions have similar risk exposure by assessing whether the designated hedging instrument is highly effective in achieving offsetting changes in cash flows attributable to each hedged risk in the group, on an individual basis, in accordance with paragraph 815-20-55-23A(a). That is, Entity Y assesses and determines that the hedging instrument is highly effective against both designated risks (ABC and DEF Soybean indexes) in the group. Entity Y uses that assessment as a "dual purpose" test to support that the forecasted transactions in the group are similar and that the hedging instrument is highly effective at achieving offsetting cash flows of the forecasted transactions, regardless of whether the ABC Soybean index or the DEF Soybean index is ultimately referenced in the not-yet-existing agreement's or agreements' pricing formula or formulas.

815-30-55-164 On June 30, 20X1, Entity Y enters into forward contracts with multiple vendors. Each agreement includes a pricing formula referencing either the Soybean ABC index or the Soybean DEF index, with a June 30, 20X2 delivery date. Entity Y assesses the hedging relationship in accordance with paragraph 815-20-25-22C and concludes that the relationship continues to be eligible for hedge accounting. Hedge accounting can continue if, for example, all forward contracts contained pricing formulas referencing only the Soybean ABC index or only the Soybean DEF index. Hedge accounting also can continue if, for example, only one forward contract is executed with a single vendor, and that contract contains a pricing formula referencing either the Soybean ABC index or the Soybean DEF index.

Issue 4: Net Written Options as Hedging Instruments

Amendments to Subtopic 815-20

11. Amend paragraph 815-20-25-88, with a link to transition paragraph 815-20-65-7, as follows:

Derivatives and Hedging—Hedging—General

Recognition

> Hedge Effectiveness

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

• • > Hedge Effectiveness When the Hedging Instrument Is an Option or Combination of Options

• • • > Determining Whether a Combination of Options Is Net Written

815-20-25-88 This guidance addresses how an entity shall determine whether a combination of options is considered a net written option subject to the requirements of paragraph 815-20-25-94. A combination of options (for example, an interest rate collar) entered into contemporaneously shall be considered a written option if either at inception or over the life of the contracts a net premium is received in cash or as a favorable rate or other term. ~~Furthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option.~~ The determination of whether a combination of options is considered a net written option depends in part on whether strike prices and notional amounts of the options remain constant. Furthermore, a derivative instrument that results from combining a written option and any other non-option derivative instrument shall be considered a written option. For cash flow hedges of interest rate risk in which the hedging instrument is a combination of a written option and any other non-option derivative instrument, an entity may make the following simplifying assumptions when performing the net written option test described in paragraphs 815-20-25-94 through 25-95:

a. The underlying interest rate embedded within the hedged forecasted transaction matches the interest rate in the hedging instrument if that interest rate is a derivation of the same nonleveraged index (for example, the underlying interest rate in the hedging instrument is based on Daily SOFR, and the underlying interest rate in the hedged forecasted transaction is based on SOFR Term).
b. The timing in which the hedged forecasted transaction is expected to occur and the settlement of the hedging instrument match if the hedged forecasted transaction occurs and the hedging instrument settles within the same 31-day period or fiscal month.
c. The interest rate reset date of the hedging instrument and the hedged forecasted transaction match if the reset date associated with the hedged forecasted transaction and the hedging instrument occurs within the same 31-day period or fiscal month.

For example, an entity that makes variable-rate loans indexed to 1-Month Term SOFR with a 1 percent floor and executes a receive-fixed, pay-variable interest rate swap with a 1 percent floor and a variable leg that is indexed to Daily SOFR may make the simplifying assumptions in (a) through (c) when performing the net written option test.

Issue 5: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

Amendments to Subtopic 815-20

12. Amend paragraphs 815-20-55-38 and 815-20-55-129, with a link to transition paragraph 815-20-65-7, as follows:

Derivatives and Hedging—Hedging—General

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 should recognize 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

assessment of effectiveness in the designated 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.~~

13. Add paragraph 815-20-65-7 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 202X-XX, *Derivatives and Hedging (Topic 815): Hedge Accounting Improvements*

815-20-65-7 The following represents the transition and effective date information related to Accounting Standards Update No. 202X-XX, *Derivatives and Hedging (Topic 815): Hedge Accounting Improvements:*

Effective date and early adoption

- a. All entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after [date to be inserted after exposure], including interim reporting periods within those annual reporting periods. Early adoption is permitted for all entities on any date.

Transition method

- b. An entity shall apply the pending content that links to this paragraph on a prospective basis, including the guidance described in (c) and (d) for existing hedging relationships (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) beginning on or after the adoption date.

c. For cash flow hedges existing as of the date of adoption, without dedesignating the hedging relationship, an entity shall:
   1. For hedges of variability in cash flows attributable to a group of individual forecasted transactions, modify its method for assessing similar risk exposure to a method described in paragraph 815-20-55-23A. If an entity is applying one of the methods described in paragraph 815-20-55-23A, it may elect to change to the other method. If an entity modifies its method of assessing similar risk exposure to the method described in paragraph 815-20-55-23A(a), the entity also may change its method of assessing hedge effectiveness if the revised method leverages the similar risk assessment in determining that the hedging relationship is highly effective.
   2. For hedges of variability in cash flows attributable to changes in a contractually specified interest rate for a hedge of forecasted interest payments on an existing choose-your-rate debt instrument, apply the guidance in paragraphs 815-30-35-37B through 35-37F.

d. For cash flow hedges existing as of the date of adoption, without dedesignating the hedging relationship, an entity may:
   1. For hedges of variability in cash flows attributable to changes in the overall price or the contractually specified component of the price in a forecasted purchase or sale of a nonfinancial asset, modify the hedging relationship to designate the hedged risk as variability in cash flows attributable to changes in a component (or subcomponent) of the forecasted purchase price or sales price of a nonfinancial asset in accordance with paragraph 815-20-25-22C. The entity is not required to amend its hedge documentation for hedges of a contractually specified component to reflect amendments in accordance with paragraph 815-20-25-22C if the hedged risk is unchanged.
   2. For hedges of variability in cash flows attributable to a group of individual forecasted transactions:
      i. Modify the hedging relationship to add an additional hedged risk or risks to an existing portfolio if the hedging relationship continues to meet all other requirements to apply cash flow hedge accounting.
      ii. Migrate some or all of the individual forecasted transactions from one existing pool or pools to a new pool or pools, an existing pool or pools, or a combination thereof.

iii. Reassign and reorder existing hedging instruments to a new or existing pool.
3. For hedges of forecasted interest payments on an existing choose-your-rate debt instrument:
   i. Amend the hedging relationship to include interest payments on replacement debt
   ii. Specify the quantitative method that an entity will use in the event that it must assess hedge effectiveness on a quantitative basis in subsequent periods (for entities assessing hedge effectiveness on a qualitative basis).
4. For hedges of forecasted interest payments that may include interest payments on an existing choose-your-rate debt instrument designated as part of a group of forecasted transactions under the first-payments-received technique:
   i. Amend the hedging relationship to include only interest payments on the individual existing choose-your-rate debt instrument and replacement debt
   ii. Specify the quantitative method that an entity will use in the event that it must assess hedge effectiveness on a quantitative basis in subsequent periods (for entities assessing hedge effectiveness on a qualitative basis).

e. If adoption of the pending content that links to this paragraph in (c) or (d) changes the designated hedged risk, an entity shall create the terms of the instrument used to estimate the change in value of the hedged risk (under the originally designated method, for example, the hypothetical derivative method or another acceptable method in Subtopic 815-30) in the assessment of hedge effectiveness and the similar risk assessment, if applicable, on the basis of market data as of the inception of the hedging relationship. Furthermore, an entity shall amend hedge documentation, including documentation of critical terms, the hedged forecasted transactions, hedge effectiveness assessments, and similar risk assessments, as needed to apply the pending content in (c) or (d) for all existing hedging relationships.

Transition disclosures

f. An entity shall disclose the nature of and reason for the change in accounting principle as well as the method of applying the change, in the interim and annual financial statement period in the fiscal year that the entity adopts the pending content that links to this paragraph.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
Hillary H. Salo, *Vice Chair*
Christine A. Botosan
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Dr. Joyce T. Joseph

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. After the issuance of Update 2017-12, stakeholders asked that the Board clarify certain aspects of the guidance in the amendments of that Update. The Board issued the 2019 proposed Accounting Standards Update, *Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting,* to better reflect the Board's objectives related to the following four issues:

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

BC3. Stakeholders indicated that the amendments in the 2019 proposed Update would not sufficiently resolve the issues identified related to the change in hedged risk in a cash flow hedge (Issue a) and contractually specified components in a cash flow hedge of nonfinancial forecasted transactions (Issue b). Stakeholders generally supported the proposed amendments related to dual hedges (Issue c). Some feedback indicated that the amendments related to the use of the term *prepayable* under the shortcut method (Issue d)

were not necessary given the absence of questions emerging from practice, the elimination of the term *prepayable* from the guidance supporting the portfolio layer method strategy, and concerns raised about the potential confusion and unintended consequences that could result from amending longstanding guidance for applying the shortcut method.

BC4. In response to the 2021 Invitation to Comment, *Agenda Consultation*, stakeholders continued to ask that the Board clarify certain aspects of Update 2017-12. Stakeholders also requested that the Board address a variety of additional issues related to hedge accounting and identified several issues resulting from the effect of the London Interbank Offered Rate (LIBOR) cessation on hedge accounting as the highest priority. After considering stakeholders' feedback, the Board decided to focus its efforts on continuing to clarify certain aspects of Update 2017-12 and addressing incremental issues arising from LIBOR cessation. In doing so, the Board decided to address two incremental issues resulting from the effects of LIBOR cessation (shared risk assessment in cash flow hedges and net written options as hedging instruments) and decided to not address one issue (use of the term *prepayable* in the shortcut method) for the reasons described in paragraph BC3.

BC5. Accordingly, based on stakeholders' feedback, the Board decided to address the following issues in this proposed Update:

a. Shared risk assessment in cash flow hedges
b. Hedging forecasted interest payments on choose-your-rate debt instruments (referred to as "change in hedged risk in a cash flow hedge" in the 2019 proposed Update)
c. Cash flow hedges of nonfinancial forecasted transactions (referred to as "contractually specified components in a cash flow hedge of nonfinancial forecasted transactions" in the 2019 proposed Update)
d. Net written options as hedging instruments
e. Foreign-currency-denominated debt instrument as hedging instrument and hedged item (dual hedge).

Benefits and Costs

BC6. 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 benefits and costs of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively quantify the value of improved information in financial statements or to measure the costs to implement new guidance.

BC7. The purpose of the amendments in Update 2017-12 was to improve the financial reporting of hedging relationships to better portray the economic results of an entity's risk management activities in its financial statements. As part of its objective to better align the hedge accounting guidance with entities' risk management activities, the Board included amendments in both Update 2017-12 and the 2019 proposed Update that were intended to allow entities greater flexibility to retain hedge accounting once a highly effective hedging relationship is established (through the proposed change in hedged risk guidance). This proposed guidance was intended to address stakeholders' concern that current guidance increases the prevalence of missed forecasted transactions for otherwise highly effective hedging relationships, thus resulting in less decision-useful information for investors.

BC8. However, after considering stakeholders' concerns that certain of those amendments deviate from the conceptual pillars of Topic 815 and would be challenging to operationalize, the Board decided to take a different approach in this proposed Update and identify more targeted solutions for different types of hedges. Accordingly, certain amendments in this proposed Update are intended to allow an entity's financial reporting to more closely reflect economic hedging strategies for highly effective cash flow hedges of groups of forecasted transactions, including nonfinancial forecasted transactions. Other amendments in this proposed Update are intended to facilitate application of cash flow hedge accounting to commonly issued debt instruments with terms that allow entities to change their interest rate over the life of the debt instrument. The Board believes these solutions would achieve the goal of reducing unintuitive missed forecasts, which would provide more decision-useful information to investors and other financial statement users about entities' risk management activities and the relative success of entities' hedging programs. In addition, the Board believes that these solutions would be more

operable for preparers and auditable for auditors compared with the 2019 proposed Update.

BC9. The Board also believes that the clarity provided by the amendments in this proposed Update would result in a more faithful representation of hedging activities in a cost-efficient manner for preparers. In some cases, the proposed amendments would provide the benefit of improving consistent application of GAAP by clarifying guidance that already exists within GAAP. In other cases, the proposed amendments necessitated by LIBOR cessation would provide the benefit of allowing Topic 815 to remain operable after the effects of global reference rate reform.

BC10. Because hedge accounting is optional, 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 would incur significant costs as a result of the proposed amendments. However, the Board acknowledges that certain reporting entities would incur costs. Those costs may include initial costs to educate employees, establish new accounting methods, and update systems and processes. The Board believes that after implementing the proposed amendments, 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 elective nature of hedge accounting would permit entities to independently determine whether the benefits of applying the proposed amendments outweigh the costs.

BC11. The basis for conclusions related to each amendment in this proposed Update provides the relevant benefit-cost analysis for that amendment.

Basis for Conclusions

Issue 1: Similar Risk Assessment for Cash Flow Hedges

BC12. Topic 815 permits entities to designate cash flow hedges of groups of forecasted transactions using a single derivative as the hedging instrument. To qualify for that approach, the individual forecasted transactions in the group must share the same risk exposure in addition to meeting all other requirements for applying hedge accounting. Stakeholders informed the Board that beyond the temporary relief provided in Topic 848, Reference Rate

Reform, after cessation of LIBOR, permanent amendments to Topic 815 would be needed to maintain the ability to apply the guidance to hedges of groups of individual forecasted transactions, given the increased variety of alternative reference rates and iterations of those rates that have emerged.

BC13. Before LIBOR cessation, hedges of variable-rate loan pools were established to hedge forecasted interest cash flows based on a particular tenor (that is, reset frequency) of LIBOR. Because LIBOR was the predominant reference rate and financial institutions could continuously replenish LIBOR-based loans, entities could readily assert that the designated forecasted interest cash flows shared the same risk exposure and were probable of occurring.

BC14. Stakeholders observed that the shared risk exposure requirement, and the related example in paragraph 815-20-55-23 that has been commonly applied in practice to restrict hedges of interest receipts to only those based on the same index, is unnecessarily restrictive in a post-LIBOR environment. Financial institution stakeholders indicated that because of the increased variety of alternative reference rates after LIBOR cessation, more granular groups (or pools) are necessary to comply with the shared risk exposure requirement to apply cash flow hedge accounting.

BC15. As loan origination terms have shifted after LIBOR cessation, pools of loans have generally become smaller and more granular because of the wider variety of alternative reference rates, resulting in an increased risk of missed forecasted transactions. In some cases, concerns about the ability to accurately forecast probable transactions at the pool level has reduced the extent to which hedge accounting has been applied. Stakeholders stated that, in their view, these challenges will persist as it remains unclear how the interest rate landscape will continue to evolve in the future.

BC16. The 2019 proposed Update would have amended paragraph 815-20-55-23 to 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. At that time, the Board noted that while it may be common for forecasted transactions in a group to vary with the same index, it did not intend to prohibit the application of hedge accounting in instances in which forecasted transactions with different interest rate indexes or commodity indexes are highly correlated. That is, the Board did not intend for the "same index" example to be interpreted as a requirement to qualify for hedge accounting.

BC17. Stakeholders strongly supported the Board's decision to remove the same index example. Stakeholders noted that removing that example would increase the degree to which the desired level of hedge accounting can be achieved by allowing the aggregation of risks within a single portfolio. In addition, stakeholders observed that it would reduce the cost and complexity of managing their hedge accounting programs and ease the burden of hedge accounting post-LIBOR cessation.

BC18. Some stakeholders noted that the term *shared* risk exposure used to describe the eligibility assessment for hedges of groups of forecasted transactions should be changed to *similar* risk exposure because removing the same index example clarifies the Board's intent that hedged risks in a pool need not share the same risk exposure. The Board agreed with stakeholders and both affirmed its decision to remove the same index example and decided to change the term *shared* risk exposure to *similar* risk exposure to avoid confusion in practice and to better reflect the intent of the amendments in this proposed Update. Also, while this issue was initially raised in the context of interest rate risk hedges of variable-rate loan pools, the Board observes that guidance related to the similar risk assessment would apply equally for commodity price risk hedges designated on a pool basis when the forecasted transactions are future purchases or sales of nonfinancial assets.

BC19. Stakeholders requested clarification on the parameters for applying the similar risk exposure requirement to ensure that the guidance is applied as the Board intended. The Board decided to provide guidance on the required frequency of the similar risk assessment, the quantitative threshold, and parameters for performing that assessment and whether a qualitative assessment may be performed. As to the frequency of the assessment, the Board decided that the similar risk assessment should be performed initially at hedge inception and on an ongoing basis (that is, a quarterly assessment at a minimum under Topic 815). That decision affirms the amendment in the 2019 proposed Update and restores the requirement for initial and ongoing assessment that was in place before the amendments in Update 2017-12 were implemented. The Board acknowledges that the requirement for ongoing similar risk assessments is necessary to address groupings of individual forecasted transactions that may include diverse contractually specified risks or overall price risks. Furthermore, stakeholders noted, and the Board agreed, that if one or more risks is dissimilar in subsequent periods, then it would be

conceptually inconsistent to permit the continuation of existing hedges but not permit new hedges on the same pool to be established.

BC20. Current GAAP does not specify the threshold necessary to conclude that risks in a group of forecasted transactions are similar, and the Board understands that after LIBOR cessation some diversity in practice has been observed. To address that issue, the Board decided that the quantitative threshold necessary to determine that risks in a group of forecasted transactions have a similar risk exposure should be consistent with the highly effective threshold.

BC21. While the term *similar* risk suggests that an entity should validate that all risks in a pool are highly correlated with one another, the Board decided that entities may conclude that the risk exposures in a group of forecasted transactions are deemed similar if the hedging instrument is highly effective against each risk in the group. The Board believes that if all hedged risks in the pool are highly effective against the hedging instrument, then each risk is sufficiently similar to every other risk in the group to be eligible to apply hedge accounting as a group. Furthermore, if each risk is highly effective against the designated hedging instrument, then an entity could achieve hedge accounting for those forecasted transactions by designating a discrete hedging relationship for each forecasted transaction.

BC22. The Board understands that this would align the amendments in the proposed Update with an approach commonly applied in current practice under which the same assessment is applied to satisfy both the hedge effectiveness assessment and the similar risk assessment, which would have the benefit of reducing the cost and complexity of applying hedge accounting for this type of strategy. That is, the Board understands that, in practice, some entities utilize a dual-purpose assessment commonly referred to as a “test to worst” approach, the premise of which is that if the derivative designated as the hedging instrument is highly effective against the least effective risk in the pool (the identification of which requires judgment that may change over time), it may be considered highly effective against every risk in the pool. However, the Board decided that if an entity elects not to utilize a dual-purpose assessment, then it would be required to assess whether the risks in the group are similar separately from its assessment of hedge effectiveness. Whether individual forecasted transactions in a group are determined to have a similar risk exposure may differ depending on the assessment method selected.

BC23. The Board decided that if an entity applies one of the qualitative methods applicable to cash flow hedges of a group of individual forecasted transactions in paragraph 815-20-25-3(b)(2)(iv)(01) for purposes of assessing hedge effectiveness, it also may assume that the hedged risks related to a group of forecasted transactions are similar. In that circumstance, the Board observes that because those methods generally require that the derivative match the items in the group, application of those methods would generally apply only to pools containing a single risk exposure.

BC24. The Board also decided that entities should be permitted to assess whether risk exposures in a group of forecasted transactions are similar using ongoing qualitative assessments, on a hedge-by-hedge basis, in a manner similar to the guidance in paragraphs 815-20-35-2A through 35-2F. The Board noted that in specifying a quantitative threshold, it did not intend to prohibit an entity from performing qualitative ongoing assessments and believes that the concepts in those paragraphs are appropriate for performing the similar risk assessment.

BC25. By expanding the risks that may be included in a group, the Board views its decisions as improving GAAP by allowing hedge accounting to be applied more broadly. The Board believes that this would be an improvement over current GAAP because investors would receive more relevant information about an entity's risk management activities. Furthermore, by clarifying the guidance necessary to conclude that a group of forecasted transactions has a similar risk exposure, the Board believes that stakeholders would be able to apply hedge accounting to more economic hedges in a more cost-effective and efficient manner.

BC26. While the Board understands that these amendments in this proposed Update would not address all potential issues encountered in practice on hedges of variable-rate loan pools, stakeholders indicated that the proposed amendments would be important incremental improvements because they would provide the flexibility to expand pools relative to current practice, which may enable entities to reduce potential missed forecasts in some circumstances.

BC27. The Board believes that the expected benefits of its decisions on the similar risk assessment would justify the expected implementation costs because stakeholders noted that the amendments in this proposed Update would improve the degree to which the desired level of hedge accounting can

be achieved by removing the impediment to aggregate certain risks within a single pool, while simultaneously reducing the costs and complexities of managing hedge programs.

BC28. The decisions reached on this issue are not intended to introduce a more rigorous analysis to determine whether individual transactions in a group have similar risks. Rather, they are meant to allow entities to assemble larger pools, while simplifying and providing greater clarity on how assessments of similar risk exposure should be performed. The Board does not foresee significant implementation costs related to education or establishing accounting policies on this issue because the revised guidance would generally be consistent with the use of dual-purpose assessments in practice.

Issue 2: Hedging Forecasted Interest Payments on Choose-Your-Rate Debt Instruments

BC29. Before the issuance of Update 2017-12, paragraph 815-20-55-56 included a broad prohibition against changing the critical terms of a hedging relationship after initial hedge designation without dedesignating and redesignating the hedging relationship. Update 2017-12 amended Topic 815 to permit entities to continue applying hedge accounting in a cash flow hedge, without dedesignation, if the designated hedged risk changes during the life of the hedging relationship and the hedging instrument is highly effective at offsetting the cash flows attributable to the revised hedged risk.

BC30. The Board's objective was to introduce flexibility into Topic 815 to enable an entity to avoid missed forecasts when the entity did not anticipate the change in hedged risk upon hedge designation, but the hedging relationship remained highly effective (considering the new risk) and continued to achieve the original risk management objective.

BC31. Stakeholders' feedback following the issuance of Update 2017-12 indicated operability concerns about the change in hedged risk guidance, leading to the issuance of the 2019 proposed Update to clarify its application. Comment letter respondents to the 2019 proposed Update conveyed numerous concerns about the amendments in that proposed Update. Some stakeholders expressed concern that the amendments, which would have permitted an entity to identify a hedged forecasted transaction with an undocumented hedged risk after the forecasted transaction occurred, would be

inconsistent with the fundamental pillars underlying Topic 815 that were established when hedge accounting was first introduced. In addition, among other concerns, many stakeholders indicated that requiring application of the change in hedged risk guidance, rather than permitting elective application, could disrupt existing practice for certain cash flow hedges.

BC32. The Board acknowledges that the change in hedged risk model in the 2019 proposed Update was intended to be a broad solution to address the risk of missed forecasted transactions. Some stakeholders noted that for the change in hedged risk model to be operable, auditable, and aligned with the existing cash flow hedging framework, it would need to be revised to be significantly more limited and prescriptive. The Board decided that revising the change in hedged risk model in that manner would not meet the Board's stated objectives. Furthermore, the Board recognized that other amendments in this proposed Update would address the risk of missed forecasts for certain types of hedges, thereby minimizing the need for a broad solution.

BC33. Accordingly, the Board decided that the change in the hedged risk model should focus on one pervasive hedging strategy for which stakeholders highlighted that the application of hedge accounting has been limited in practice, and diversity exists when it is applied. Specifically, the Board decided to address cash flow hedges of individual variable-rate debt instruments that permit the borrower to change either or both the interest rate index and interest rate tenor upon which interest is accrued. That type of instrument is commonly referred to as "choose-your-rate" debt. The Board believes that a change in hedged risk model is well suited for application to that hedging strategy because the terms of the debt instrument explicitly allow a borrower to change either or both the interest rate index and interest rate tenor and also specify the rates and tenors that may be selected. Furthermore, the approach for applying cash flow hedge accounting to this type of instrument is not specified in Topic 815, which has led to diversity in practice.

BC34. The Board decided that the central provision of a change in hedged risk model for choose-your-rate debt is that upon hedge designation, the terms of the issued debt instrument establish the parameters of the hedging relationship and the complete set of risks that an entity may change to during the hedging relationship. Accordingly, the Board believes that the terms of the issued debt instrument serve as sufficient documentation of the potential hedged risks that may be selected during the hedging relationship. As such, no

incremental documentation of a list, sequence, or "waterfall" of interest rate indexes or interest rate tenors of those rates that an entity may change to during the life of the hedging relationship would be necessary. In addition to allowing entities to utilize the purchased optionality in those debt instruments without risk of a missed forecast, the Board believes that this approach has the benefit of avoiding the loss of hedge accounting because of unforeseen omissions in hedge documentation. In addition, the Board believes that this approach has the benefit of simplifying the application of hedge accounting for entities that issue choose-your-rate debt, which is a commonly issued form of debt instrument.

BC35. The Board decided that an entity should be permitted to continue hedge accounting for a replacement of a choose-your-rate debt instrument upon a refinancing to the extent that, upon replacement, the entity selects a rate that is captured within the terms of the original debt issuance and the interest payments remain probable of occurring over the hedge period. The Board believes that replacement of a choose-your-rate debt instrument should be accommodated because refinancings are commonplace and the replacement debt (whether a variable-rate debt instrument with a single interest rate index or a choose-your-rate debt instrument) may be viewed as linked to the original hedged debt if the selected rate is present in the terms of the original debt instrument and the interest payments remain probable of occurring over the hedge period.

BC36. Because the terms of the original issued debt instrument establish the parameters of the hedging relationship, to continue hedge accounting without dedesignation, the Board believes that the original notional amount designated as being hedged and the original term of the hedging relationship may not be changed upon replacement of the originally designated choose-your-rate debt instrument. That is, the replacement debt instrument must have a notional amount equal to or greater than the amount of the principal hedged under the original choose-your-rate debt instrument and the replacement debt instrument must mature on or after the last interest payment hedged under the original choose-your-rate debt instrument.

BC37. The Board decided that at hedge inception the assessment of hedge effectiveness would be based on the single rate on which interest is accrued, ignoring the optionality embedded in the debt instrument, including alternative rates previously selected or rates anticipated to be selected in the future. The

Board believes that would simplify the assessment and permit entities to assess hedge effectiveness on a qualitative basis. The Board also observes that an entity would not need to assess the similarity of all interest rates available to be selected because only the selected interest rate is designated as the hedged risk at any given point in time.

BC38. When an entity changes to a new interest rate index or interest rate tenor in accordance with the terms of the debt agreement giving rise to the interest cash flows designated as the hedged forecasted transactions, it would perform a final retrospective assessment based on the previously elected contractually specified rate and then begin prospectively assessing hedge effectiveness based on the revised contractually specified interest rate. In performing those assessments using the revised rate, the entity would create the terms of the instrument used to estimate changes in the cash flows of the revised hedged risk based on the market data as of the inception of the hedging relationship, which would avoid an off-market element being captured in effectiveness assessments.

BC39. If an entity fails the final retrospective assessment but passes the prospective assessment using the revised rate, the entity would not apply cash flow hedge accounting for the period covered by that final retrospective assessment but may apply cash flow hedge accounting prospectively. That is because the derivative is expected to be highly effective in offsetting forecasted cash flows based on the entity's decision to change the rate upon which interest will be accrued going forward, in accordance with the terms of the debt instrument.

BC40. The Board decided that the assessment of the probability of forecasted transactions occurring would be based on the likelihood that interest payments on the choose-your-rate debt instrument (or replacement debt) will occur, without consideration of the likelihood that it will exercise the option to change the selected rate and tenor on which interest is accrued. The Board decided that the interest rate tenor is permitted to change if the revised payments are accrued over the hedge period. While the Board recognizes that a change in tenor of an interest rate also represents a change in the number and timing of interest payments, it decided that within the confines of this model, an entity may view the interest accruals on that discrete debt instrument (or replacement debt) as the hedged cash flows. Accordingly, a change in the number and frequency of hedged cash flows that results from an entity selecting a different

interest rate index, including tenor, would not result in a missed forecast within this model.

BC41. The Board decided that entities should be required to apply (rather than have the election to apply) the change in hedged risk model in the amendments in this proposed Update when hedging interest payments on choose-your-rate debt under Topic 815, given the implicit benefits of the model. The Board believes that the proposed amendments would establish a model for hedging interest payments on choose-your-rate debt that reduces operational complexity, mitigates the risk of unintuitive missed forecasts or dedesignation events, and more consistently reflects risk management strategies in the financial information provided to investors. The Board decided that because the elements of this model have been tailored to the features of variable-rate debt instruments that permit a borrower to select at each reset period the interest rate index (including the tenor of the interest rate, if applicable) from a contractually specified list upon which interest is accrued (that is, choose-your-rate debt), the model should not be applied by analogy to other hedging relationships, including relationships in which forecasted transactions are identified in accordance with the first-payments-received technique.

BC42. The Board believes that the expected benefits of the amendments in this proposed Update for hedges of choose-your-rate debt would justify the expected implementation costs. The Board understands that stakeholders have been seeking clarification of this cash flow hedging strategy for many years and anticipates that the proposed amendments would simplify application of a common hedging strategy in a manner that best aligns with the economics of entities' risk management activities. On the basis of outreach with stakeholders, the Board expects that the proposed amendments would eliminate the diversity in practice that currently exists about the application of cash flow hedge accounting to choose-your-rate debt instruments. Moreover, the Board expects that entities would experience little, if any, change in their processes or internal controls for this hedging strategy upon adopting the proposed amendments. Therefore, the Board does not foresee significant implementation costs for education or establishing accounting policies related to the proposed amendments.

Issue 3: Cash Flow Hedges of Nonfinancial Forecasted Transactions

BC43. For cash flow hedges of the forecasted purchase or sale of a nonfinancial asset, Update 2017-12 introduced guidance to allow entities to designate hedges of a contractually specified component of the pricing formula within a purchase or sale agreement. In doing so, the Board sought to better align hedge accounting with an entity's risk management activities. The central element of this model is that the contractually specified component must be explicitly referenced (or expected to be explicitly referenced) in the pricing formula of an agreement that supports the nonfinancial asset's transaction price.

BC44. The Board selected this approach for hedging nonfinancial price components in Update 2017-12 because it believes that designating the variability in cash flows attributable to changes in a contractually specified component as the hedged risk is objective and relatively straightforward to apply (that is, a contractually specified component has a direct and measurable effect on the transaction price). In addition, the amendments in Update 2017-12 require that for an entity to designate a component in a forward contract that is a derivative in its entirety, the entity must apply the normal purchases and normal sales (NPNS) scope exception to ensure that no extraneous or speculative price component would be eligible for cash flow hedging.

BC45. Following the issuance of Update 2017-12, stakeholders asked the Board to clarify several issues on the contractually specified component hedging model. Those issues included specifying the type of contract or agreement necessary to support the existence of a contractually specified component and when that contract or agreement must be received, how the guidance interacts with the NPNS scope exception, how an entity should assess whether a contractually specified component determines the transaction price of a nonfinancial asset, and how the contractually specified component guidance should be interpreted for forecasted transactions consummated in the spot market.

BC46. The 2019 proposed Update sought to clarify those matters. The amendments in that proposed Update indicated that any documentation that supports the price at which a nonfinancial asset is purchased or sold may be evidence of a contractually specified component. Furthermore, the proposed amendments specified that an entity would be required to apply only the portion

of the NPNS scope exception that requires all underlyings in the agreement to be clearly and closely related to the asset being purchased or sold (rather than being required to qualify for and elect the NPNS scope exception, which includes meeting additional conditions). In response to some practitioners' concerns about the operability and auditability of the model for spot transactions, the Board sought to clarify that agreements supporting the contractually specified component need not be legally binding or executed in advance of the transaction and provided examples of the type of documentation (such as a spot-market receipt) that would satisfy this requirement.

BC47. Stakeholders expressed concerns about the operability of the nonfinancial component hedge accounting model under both Update 2017-12 and the 2019 proposed Update. The ability to hedge component risks in spot-market transactions was the most pervasive issue raised by stakeholders. Some stakeholders expressed that the existing contractually specified component model, which relies on written evidence that a price component is explicitly referenced in a pricing formula of an agreement governing the transaction, is incompatible with the mechanics of a spot market. The Board understands that this has created challenges in the application of hedge accounting and diversity in practice for hedges of price components in forecasted nonfinancial transactions consummated in the spot market.

BC48. Stakeholders consistently expressed support for a nonfinancial component hedging model that permits hedges of price components beyond those that are contractually specified in a pricing formula. Stakeholders indicated that permitting hedges of price components beyond contractually specified components would make it easier to achieve hedge accounting for forecasted transactions without the need to execute the purchase through a forward contract.

BC49. The Board agreed with that view, noting that a component hedging model that limits the application of hedge accounting for a population of forecasted transactions (that is, spot-market transactions) based on the selected marketplace for the transaction is not ideal because it precludes an entity from applying hedge accounting to a subset of risk management strategies. Accordingly, the Board decided to develop a principle-based model for cash flow hedges of nonfinancial price components.

BC50. The Board decided to propose a revised nonfinancial component hedging model with eligibility based on the clearly-and-closely-related criteria in the NPNS scope exception under Topic 815. Under that model, entities may designate the variability in cash flows attributable to changes in a component of the price of a nonfinancial asset as the hedged risk if the component presents an exposure to cash flow variability that could affect reported earnings and is clearly and closely related (as described in paragraph 815-10-15-32(a) and (b)) to the purchase or sale price of the nonfinancial asset.

BC51. In evaluating whether the hedged price component presents an exposure to cash flow variability that could affect reported earnings, the Board observed that the assessment of whether cash flow variability exists would differ depending on the nature of the transaction used to purchase or sell the nonfinancial asset. The Board noted that the cash flow variability in a forecasted transaction executed through a forward agreement stems from the components that are explicitly referenced in that agreement's pricing formula. The Board believes that this results in an inherent limitation of the population of components eligible to be designated as the hedged risk because the existence of the contract evidences the source of cash flow variability in the forecasted purchase or sale transaction.

BC52. However, the Board decided that the components that may be designated are not limited to only the explicitly referenced variable components in the contract but also would include variable components that are clearly and closely related to an explicitly referenced component (that is, subcomponents as described in paragraph 815-20-25-22C(b)(2)). The Board believes that it is reasonable to consider factors such as ingredients, factors in production, or fair value inputs when applying the clearly-and-closely-related analysis for determining eligible subcomponents of explicitly referenced components. In addition, the Board observes that entities may not be able to identify whether a subcomponent is the highest-level ingredient, factor, or input to the explicitly referenced component and, therefore, did not impose a requirement for performing an assessment of whether a subcomponent is clearly and closely related to other higher-level subcomponents that make up the explicitly referenced component.

BC53. The Board also noted that the cash flow variability in a forecasted transaction consummated in the spot market stems from the total price that is ultimately paid or received. The Board believes that, relative to a forward contract, there is a broader population of eligible hedged risks for transactions

executed in the spot market because the cash flow variability from the forecasted transaction is not inherently limited by a contractual pricing formula. Rather, an entity would be permitted to designate as the hedged risk any component that would be considered to create variability in the spot price depending on the nature of the commodity, the market, the location, and so forth, if the required hedge designation criteria are met.

BC54. The Board observed that entities often enter into derivatives as hedges of price variability attributable to forecasted purchases of nonfinancial assets before entering into a forward contract, commonly referred to as a hedge of a "not-yet-existing" contract. In that circumstance, the Board understands that an entity may ultimately purchase the nonfinancial asset through multiple forward contracts or through a combination of forward contracts and spot transactions.

BC55. The Board believes that when an entity does not know the component that will be explicitly referenced in the contract or contracts when consummated, it would need to carefully consider the possible components that may ultimately be explicitly referenced and may need to perform a similar risk assessment considering the possible price components. An entity also would have to satisfy the clearly-and-closely-related requirements for designating nonfinancial components. If an entity hedges a not-yet-existing contract and later executes a forward contract, it would then assess the hedging relationship under the clearly-and-closely-related guidance for hedges of explicitly referenced components to determine whether hedge accounting can continue.

BC56. The Board also determined that entities may designate the variability of multiple nonfinancial hedged components as the hedged risks in a cash flow hedge, subject to meeting the requirement that the forecasted transactions have a similar risk exposure applicable to hedges of groups of individual forecasted transactions as well as all other hedge accounting requirements. The application of the similar risk assessment would be required for hedges of multiple risks that may arise from existing forward contracts to purchase or sell nonfinancial assets, a not-yet-existing contract or contracts to purchase or sell nonfinancial assets, or forecasted purchases or sales of nonfinancial assets that will be consummated in the spot market.

BC57. The Board decided to base eligibility for nonfinancial component hedging on the clearly-and-closely-related criteria within the NPNS scope exception because it is a well-understood concept and would place appropriate

limitations on the price components that can be designated. Specifically, the requirement in paragraph 815-10-15-32(a) would ensure that the price components are not extraneous to both the cost and changes in fair value of the asset being purchased or sold (including being extraneous to an ingredient or direct factor in the production of that asset). The requirement in paragraph 815-10-15-32(b) would ensure that there is no leverage present based on the requirement that the magnitude of the price adjustment based on the underlying is not significantly disproportionate to the effect of the underlying on the fair value or cost of the asset being purchased or sold (or of an ingredient or direct factor, as appropriate).

BC58. Some stakeholders expressed concern that paragraph 815-10-15-32(b) may require a quantitative correlation test, which in their view may not allow hedge accounting to be applied to the degree that the Board intended. However, the Board understands that using a quantitative assessment to support the clearly-and-closely-related assessment under the NPNS scope exception has generally been limited to determining whether any leverage features exist and would expect the same practice to be applied for purposes of assessing whether a nonfinancial component is eligible for hedge accounting.

BC59. The Board understands from stakeholders that a model based on the clearly-and-closely-related principle within the NPNS scope exception would be operable because it is a longstanding concept in GAAP. The Board expects that this decision would have a minimal effect on entities that want to continue to hedge an explicitly referenced component in a pricing formula pursuant to a forward contract, because, under current GAAP, entities already assess whether the component is clearly and closely related to the price of the nonfinancial item being purchased or sold.

BC60. Currently, depending on whether the contract meets the definition of a derivative, the clearly-and-closely-related assessment would be slightly different. If the contract meets the definition of a derivative, entities apply the clearly-and-closely-related guidance as part of the assessment of the NPNS scope exception to determine whether the contractually specified component within that contract can be designated as the hedged risk. However, if the purchase or sale contract does not meet the definition of a derivative, then entities assess whether the component is clearly and closely related to the host contract under the bifurcation guidance for embedded derivatives to determine

whether the contractually specified component can be designated as the hedged risk.

BC61. The Board observed that in both cases the purpose is to identify extraneous components that the Board believes should not be eligible for hedge designation. Therefore, the Board observed that requiring the clearly-and-closely-related criteria under the NPNS scope exception would not be a significant change from current practice and would extend the analysis already required for designating a contractually specified component under current GAAP for contracts that meet the definition of a derivative to forecasted transactions in the spot market.

BC62. The Board also considered an alternative that would have replaced the existing contractually specified component model with the guidance in International Financial Reporting Standard (IFRS) 9, *Financial Instruments,* that permits designation of a separately identifiable and reliably measurable component of the total price of the nonfinancial item. That approach permits designation of price components in a forecasted nonfinancial transaction that are distinct and contribute to the total price risk of the nonfinancial asset (that is, separately identifiable) and possess observable market prices (that is, reliably measurable).

BC63. The Board received feedback from stakeholders that developing a model grounded on the clearly-and-closely-related principle was preferable to incorporating the separately identifiable and reliably measurable principle under IFRS 9 for several reasons. Stakeholders noted that application of the separately identifiable and reliably measurable principle may differ under GAAP and IFRS Accounting Standards because of differences in the base hedging frameworks. Incremental guidance would be needed to incorporate defined terms and concepts used under IFRS 9 such as the terms *market structure* and *market convention*, to ensure that the FASB's stakeholders would understand and consistently interpret those concepts. Stakeholders also indicated that application of hedge accounting under IFRS Accounting Standards is largely limited to forecasted purchases or sales of nonfinancial assets consummated pursuant to a forward contract, rather than spot transactions. Therefore, incremental analysis would be required to apply that model to spot market transactions in practice.

BC64. In contrast, stakeholders asserted that while the use of the clearly-and-closely-related principle in the context of hedge accounting would be a new

application of that guidance that may require some different considerations, the judgments necessary would be grounded in experience with that principle in practice. The Board agreed with the observations made by stakeholders and, for those reasons, believes that the clearly-and-closely-related principle for hedging price components in nonfinancial forecasted transactions would achieve the desired goal of permitting more risk management strategies to apply hedge accounting while avoiding any potential operability challenges that may result from incorporating the separately identifiable and reliably measurable principle into GAAP.

BC65. The Board believes that a model based on the clearly-and-closely-related principle is a significant improvement over the existing contractually specified component model because it allows entities to apply hedge accounting regardless of the nature of the nonfinancial purchase or sale transaction that creates the risk being hedged. That is, relative to current GAAP, which limits designation of nonfinancial components to those that are contractually specified, the Board expects that the clearly-and-closely-related principle would expand hedge accounting for forecasted purchases and sales of nonfinancial items because it would more broadly permit hedge accounting of components for forecasted spot transactions and expand eligible component hedges for forward contracts to include subcomponents of components explicitly referenced in a contract's pricing formula. The Board also observes that more hedges may qualify for the critical terms match method of assessing hedge effectiveness with the expanded ability to designate a component or subcomponent as the hedged risk in a nonfinancial purchase or sale transaction.

BC66. The Board also believes that an important advantage of this model relative to current GAAP is that it may allow entities to avoid missed forecasts for highly effective economic hedges in certain circumstances. For example, if an entity experiences an unexpected shortfall in the forecasted amount of a nonfinancial asset to be purchased under a forward contract and makes up the shortfall through a spot market purchase, hedge accounting could be preserved under a model based on the clearly-and-closely-related principle if the component being hedged is clearly and closely related to both the forward price and the spot price of the nonfinancial asset. Therefore, the Board believes that this model would achieve its objective of more closely aligning entities' economic hedging strategies with hedge accounting to better portray those strategies in financial reporting.

BC67. The Board does not foresee significant implementation costs related to education or establishing accounting policies related to the new model. However, for entities that historically have not been able to hedge components of forecasted nonfinancial transactions, or otherwise elected not to apply hedge accounting for nonfinancial components, there may be costs incurred to introduce new or amend existing processes and internal controls to implement the new model and educate employees. Nevertheless, because cash flow hedge accounting is an election, only entities that elect to apply cash flow hedge accounting would be affected. The Board believes that the potential benefits of its decisions related to cash flow hedges of forecasted nonfinancial purchases and sales justify the potential implementation costs because they would expand the population of economic hedging strategies to which hedge accounting may be applied, thus allowing a greater number of entities to better reflect the results of their risk management activities in their financial statements.

Hedging Nonfinancial Components in Contracts Accounted for as Derivatives

BC68. In outreach conducted after Update 2017-12 was issued, stakeholders informed the Board of diversity in practice on 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 (that is, where the NPNS scope exception is not applied) qualifies for hedge accounting. This diversity stems from different views on whether the guidance in paragraph 815-20-25-15(d) through (e) allows the forecasted purchase or sale of a nonfinancial asset accounted for as a derivative to be designated in a cash flow hedge.

BC69. 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. That interpretation may be analogized to an all-in-one hedge.

BC70. 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.

BC71. 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 NPNS scope exception in Topic 815 is applied.

BC72. The 2019 proposed Update sought to clarify that a forecasted 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. The Board agreed with some stakeholders who maintained that the price variability associated with the forecasted purchase or sale of the nonfinancial asset that is recognized upon settlement should be eligible to be hedged because the variable component is always "at market" and, therefore, does not affect the fair value of the derivative.

BC73. The amendments in that proposed Update would have clarified 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 physical settlement of the contract accounted for as a derivative is probable in accordance with paragraph 815-20-25-15(b) 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 currently in earnings.

BC74. Stakeholders expressed concern that by specifying that the contract, as opposed to the forecasted transaction, must be probable of physical settlement, the amendments in the 2019 proposed Update would have prevented entities from applying hedge accounting to many common types of forecasted purchases and sales in which the forecasted transaction is probable of occurring but the entity is uncertain which specific contract is probable of physically settling.

BC75. The Board acknowledged that the proposed physical settlement requirement at a contract level unit of account is unnecessarily burdensome and arbitrary from a risk management perspective. Therefore, the Board decided to not finalize the amendments in the 2019 proposed Update. Instead, the Board decided to clarify that the guidance in paragraph 815-20-25-15(e) that prohibits hedge accounting from being applied to a forecasted transaction that relates to a recognized asset or liability that is remeasured in earnings for changes in fair value attributable to its hedged risk does not preclude hedging a variable price component in a forward contract accounted for as a derivative if changes in the fair value of the derivative are not attributable to the hedged risk. The Board believes that the amendment in this proposed Update would better align with the broader cash flow hedging framework.

Issue 4: Net Written Options as Hedging Instruments

BC76. For a cash flow hedge involving a hedging instrument that is deemed to be a net written option to be eligible for cash flow hedge accounting, Topic 815 requires symmetry of the gain and loss potential of the combination of the hedged item and the net written option. Following the cessation of LIBOR and the introduction of the Secured Overnight Financing Rate (SOFR) in the United States, stakeholders highlighted an issue about the application of the net written option test for lending institutions that enter into loans and derivatives with "mirror image" caps or floors. Many lending institutions enter into interest rate swaps with mirror-image options to better mitigate their exposure to interest rate risk arising from lending activity, which requires application of the net written option test to determine whether the compound derivative (the swap and the written cap or floor) is eligible for hedge accounting.

BC77. The net written option test was developed more than 25 years ago when LIBOR was the predominant reference rate. In that environment, both the variable leg of the interest rate swap and the variable loans were tied to the same LIBOR tenor. As a result, historically, assuming all other relevant criteria were met, these compound derivatives were eligible to be designated in a cash flow hedging relationship because the potential for favorable cash flows stemming from this relationship would equal or exceed the potential for unfavorable cash flows. After LIBOR cessation, it became common for the variable leg of the interest rate swap to be tied to Daily SOFR, which often does not match the rate on the variable-rate loans (which may be tied to Term SOFR or Daily SOFR with a different compounding convention).

BC78. While the economic substance of the two relationships (pre- and post-LIBOR cessation) are similar, the relationship executed in a LIBOR environment would pass the net written option test to be eligible for hedge accounting, while the relationship executed in the post-LIBOR environment would not, rendering it ineligible for hedge accounting. This is because in the post-LIBOR environment symmetry would not exist in all possible percentage changes in the underlying because the underlying interest rates do not match.

BC79. Stakeholders requested that the net written option test be amended because, in their view, this guidance was not written to contemplate a post-LIBOR environment in which the underlyings in the hedged item and hedging instrument do not match. To resolve this issue, the Board decided to amend the guidance for applying the net written option test when the designated hedging instrument in a cash flow hedge is a compound derivative made up of a written option and a non-option derivative to allow entities to assume that certain terms of the compound derivative and the hedged item are matched for purposes of applying the test.

BC80. That is, the interest rate of the hedged transaction and hedging instrument would be considered to match if it is a derivation of the same index, and the timing of occurrence of the hedged transaction and the settlement of the hedging instrument (as well as reset dates) would be considered to match if they are within the same 31-day period or fiscal month. The Board believes that these are reasonable adjustments to accommodate differences in rates and minor differences in payment or reset dates associated with those rates as a result of reference rate reform, which would cause otherwise highly effective hedging strategies to fail the net written option test.

BC81. The Board considered, but rejected, an alternative that would have removed the net written option test from Topic 815. Some stakeholders noted that the test may not be necessary given that current guidance requires hedging relationships to be highly effective and that the test limits application of hedge accounting for certain risk management activities, thereby not reflecting the economics of those hedges. For example, although Daily SOFR and SOFR Term are derived from the same index and move in tandem (albeit, with a timing lag), the fact that those rates are not identical automatically precludes hedge accounting for what may otherwise be considered a highly effective economic hedging strategy. In addition, some stakeholders noted that eliminating the net written option test could reduce the cost burden associated

with hedging using option contracts and could increase the application of hedge accounting for common highly effective hedging strategies.

BC82. The Board also considered, but rejected, another alternative that would have changed the scope of the net written option test by removing the requirement that compound hedging instruments made up of a written option and any other non-option derivative instrument (for example, an interest rate swap) are presumed to be a net written option. This would have addressed situations in which an interest rate swap with a written option is designated as a hedge of a loan with the same embedded purchased option, where the addition of the written option to the interest rate swap results in a better economic hedge but would cause the strategy to fail the net written option test. This alternative would have addressed many of the same concerns as removing the net written option test altogether but would have taken a more targeted approach by excluding a particular compound instrument from the test to address the most common circumstance creating unintuitive outcomes under current GAAP.

BC83. The Board decided not to eliminate the net written option test or change the scope of that test because it believes that it serves an important purpose that is incremental to the hedge effectiveness assessment. Some Board members noted that the requirement for symmetry of the gain and loss potential of the combined hedged position was intended to preclude a written option that is used to sell a portion of the gain potential on an asset or liability from being eligible for hedge accounting. While some of those strategies are explicitly prohibited in GAAP (for example, covered call strategies that are explicitly prohibited by paragraph 815-20-55-45), eliminating the test may permit other strategies involving options, combinations of options, or combinations of options and non-option derivatives to qualify for hedge accounting, which some may view as inconsistent with the original intent of the guidance.

BC84. The Board decided that an amendment that is narrow in scope would address stakeholders' concerns about interest rate differentials and minor differences in payment or reset dates causing otherwise highly effective hedging strategies to fail the net written option test. The Board believes that the expected benefits of its decision related to the net written option test would justify the expected implementation costs because it is a practical solution to the narrow problem facing practice. The Board believes that its decision would

improve the operability of the net written option test for cash flow hedges in which the designated hedging instrument is a compound derivative comprising a written option and any other non-option derivative instrument. Because the amendments in this proposed Update would simplify the net written option test by permitting entities to assume that certain key terms in the relationship match, the Board does not foresee significant implementation costs related to this issue.

Issue 5: Foreign-Currency-Denominated Debt Instrument as Hedging Instrument and Hedged Item (Dual Hedge)

BC85. 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.

BC86. 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 current GAAP as a result of the amendments in Update 2017-12.

BC87. 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. Therefore, to resolve that issue, the amendments in the 2019 proposed Update would have excluded the fair value hedge basis adjustment 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.

BC88. The Board decided to affirm the amendments in the 2019 proposed Update to 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. The Board continues to believe that this was an unintended consequence of the amendments in Update 2017-12, which were not intended to diminish the utility of the dual hedge strategy.

BC89. In addition, the amendments in the 2019 proposed Update would have been applied only to foreign-currency-denominated debt instruments that are both a hedging instrument and a hedged item and specified that the guidance 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 have considered the debt instrument's fair value hedge basis adjustment when prospectively assessing the effectiveness of the net investment hedge. The Board decided to affirm the amendments in the 2019 proposed Update that specified that the guidance should not be applied by analogy to other circumstances and that 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 because it ensures alignment of all net investment hedges once the source of the presentation mismatch has been eliminated.

BC90. The Board believes that the expected benefits of its decision on dual hedging relationships would justify the expected implementation costs because it will restore the ability to apply this hedging strategy without the earnings volatility for a hedge that may achieve a perfect economic offset of changes

attributable to both interest rate risk and foreign exchange risk. The Board does not foresee significant implementation costs for education or establishing accounting policies because the Board's decision would restore the guidance that had been in place before the issuance of Update 2017-12. That is, entities are already familiar with the strategy and mechanics necessary for its application.

Effective Date and Transition

BC91. The Board will determine the effective date of this proposed Update after considering stakeholders' feedback. The Board decided to permit early adoption for all entities on any date after issuance of the final Update because it expects that some stakeholders may want to adopt the guidance before the mandatory effective date.

BC92. The Board decided that entities would be required to apply the amendments in this proposed Update on a prospective basis for all hedging relationships. The Board considered whether a retrospective transition approach would be necessary to provide for the consistent use of the same accounting methodology from one historical accounting period to another and to enhance the comparability of financial statements between periods. For each of the proposed amendments in this project, the Board determined that a retrospective transition approach would not be necessary because affected hedging relationships already qualify for hedge accounting under the current guidance. Furthermore, the changes made to the critical terms of the hedging relationship in accordance with the proposed amendments only affect the ongoing (that is, future) assessments necessary to retain hedge accounting and, therefore, do not result in adjustments to the financial statements at the date of adoption.

BC93. The Board decided to provide incremental guidance to facilitate transition for entities with existing 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) that would be affected by the amendments in this proposed Update. For the issue on the similar risk assessment for cash flow hedges, the Board decided to permit entities to migrate some or all forecasted transactions associated with one or more risks from one existing pool or pools to a new pool or pools, existing pool or pools, or a combination thereof, and to reassign existing hedging instruments to those

new or existing pools as appropriate. The Board understands that entities with existing hedges using a "first-of" approach will have already assigned a significant portion of their forecasted transactions with common risk-types to an existing pool and, therefore, this provision is necessary to enable entities to obtain the benefit of the proposed amendments on the similar risk exposure assessment without dedesignating a significant portion of their existing hedging relationships.

BC94. In addition, the Board decided to provide entities with the option to amend existing hedging relationships to add an additional hedged risk or risks to an existing portfolio, which the Board believes would benefit those entities that were previously precluded from pooling transactions with similar risks. Additionally, the Board decided to require that entities change their method of assessing similar risk exposure to one of the approaches specified in the amendments in this proposed Update. If an entity is already applying one of the proposed methods of assessing similar risk exposure, the Board decided that the entity may change to the other method upon adoption. Also, if an entity wishes to perform one assessment that satisfies both the similar risk exposure assessment and the effectiveness assessment, it would be able to change its method of assessing hedge effectiveness to achieve that streamlined objective.

BC95. For the issue on hedging forecasted interest payments on choose-your-rate debt instruments, the Board believes that the transition provisions that require an entity to apply the amendments in this proposed Update to existing hedging relationships would lessen the operational burden of adoption and ensure that entities consistently apply the proposed amendments. The Board understands that current practice has resulted in the majority of existing hedges of interest payments on choose-your-rate debt being established using a "narrow" designation technique, which would not have allowed entities to designate the hedging relationship to contemplate replacement debt. Additionally, those entities leveraging a qualitative assessment method would not have documented a fallback quantitative assessment method. Therefore, the Board decided that entities should have the option to amend, upon adoption and without dedesignating the hedging relationship, their hedge documentation to reflect either or both of those aspects of the proposed model, which could be equally relevant to avoid unintuitive accounting outcomes for existing hedges.

BC96. The Board also observed that a choose-your-rate debt instrument may be designated as part of an existing hedging relationship using the first-payments-received technique such that it would not qualify for the amendments in this proposed Update. To facilitate adoption of the proposed amendments, the Board decided that an entity may change its designation approach in those circumstances in transition to qualify for the proposed amendments. If an entity elects not to change its hedge designation, the proposed amendments that would require the designated contractually specified interest rate to change when the entity selects a new interest rate index or interest rate tenor (if applicable) would not apply.

BC97. For the issue on cash flow hedges of nonfinancial forecasted transactions, the Board decided that entities should be permitted, but not required, to amend their designated hedged risk for existing hedges to reflect the changes to the guidance given the overlap in eligibility criteria between the existing contractually specified component model and a model based on the proposed clearly-and-closely-related principle. The Board anticipates that existing hedges of contractually specified components generally would be eligible for hedge accounting under the clearly-and-closely-related guidance because of the current requirements for (a) the hedged risk to be explicitly referenced in the pricing formula of an agreement to purchase or sell a nonfinancial asset and (b) the price component to be clearly and closely related to the nonfinancial asset.

BC98. Although contracts that are not derivatives in their entirety were previously assessed under the clearly-and-closely-related guidance for bifurcation of embedded derivatives rather than the clearly-and-closely-related guidance related to the NPNS scope exception, given the similar objectives of those assessments, the Board believes that an existing contractually specified component hedge is expected to also qualify under a model based on the clearly-and-closely-related principle. Therefore, the Board considers an additional analysis to be perfunctory in those circumstances.

BC99. For each of those discrete issues, the Board decided that prospective hedge effectiveness assessments should be performed as though the revised relationship and the amendments in this proposed Update had been in place since the hedge designation date, thereby avoiding any hedge ineffectiveness resulting from the passage of time between hedge inception and the date of adoption. That is, an entity should create the terms of the instrument used to

estimate changes in the cash flows of the hedged risk on the basis of market data as of hedge inception. The Board believes that this accommodation would allow an entity to more accurately reflect its risk management activities in financial reporting immediately upon adoption. This transition approach was utilized by the Board in Update 2017-12 to address the same issue, with no known challenges emerging in practice.

BC100. The Board also decided to clarify that if an entity is revising a hedging relationship's critical terms (including the hedged forecasted transactions or its method of assessing effectiveness or similar risk exposure) in accordance with the transition provisions in this proposed Update, the entity also would be permitted to revise the corresponding hedge documentation, without hedge dedesignation, to reflect those changes. Without that clarification, stakeholders indicated that it would be unclear whether an entity would be required to dedesignate all hedging relationships modified as a result of adopting the amendments in this proposed Update when the entity updated its hedge documentation in transition. The Board understands that there could be situations in which the hedged forecasted transactions are defined by the designated hedge risk. Accordingly, if an entity changes the designated hedged risk as permitted upon adoption of the proposed amendments, then it would also need to amend the hedged forecasted transactions without dedesignation to fully effectuate transition.

BC101. The Board believes that no specific transition guidance is needed for the amendments in this proposed Update on dual hedging relationships and net written options as hedging instruments because the proposed amendments would be applicable only to hedges designated upon or after the adoption date. The Board based this decision on stakeholders' feedback indicating that the dual hedging strategy lost its utility because of the recognition and presentation mismatch created by the amendments in Update 2017-12, and, as a result, the Board is unaware of dual hedging relationships currently existing in practice. The Board also is unaware of any existing hedging relationships in which a compound derivative made up of a written option and a non-option derivative has been designated as the hedging instrument in a cash flow hedge where there is a mismatch between the interest rate index on the hedged item and the derivative. The Board similarly received feedback from stakeholders indicating that this type of hedging relationship has lost its utility following the LIBOR cessation.

BC102. For the transition disclosures, the Board considered the standard disclosure requirements in Topic 250, Accounting Changes and Error Corrections. Given a prospective transition approach, the Board decided to limit the proposed transition disclosures to the nature of and reason for the change in accounting principle and the method of applying the change. The Board decided that an entity that issues interim financial statements must provide those disclosures in the financial statements of both the interim period of the change and the annual period of the change.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.