Deloitte.

Accounting Journal Entry

FASB Tentatively Decides on Hedge Accounting Transition

March 28, 2016 — At its meeting last week, the FASB made tentative decisions about the following transition issues related to its hedge accounting project: (1) alternatives for adoption, (2) disclosures, (3) optional elections, and (4) specific considerations for fair value hedges.

Alternatives for Adoption

The Board tentatively decided that as of an entity's adoption date of the final standard, the entity could apply to existing hedging relationships either (1) a modified retrospective approach or (2) a full retrospective approach.

Under the modified retrospective approach, an entity with cash flow or net investment hedges "would record the cumulative effect of the application of the recognition requirements in accumulated other comprehensive income with an offsetting adjustment through the opening balance of retained earnings as of the adoption date."[1] In addition, the entity would:

- Still "be required to provide the tabular disclosures resulting from the application of current guidance for comparative periods before the date of adoption."
- Need to "provide the new tabular disclosures for the periods after the date of adoption."

An entity applying the full retrospective approach would provide the new tabular disclosures for all periods presented.

The Board tentatively decided to allow an entity applying either approach to early adopt the amendments at the beginning of any fiscal period before the effective date. An entity electing to early adopt would have to adopt all of the amendments on one date (i.e., it could not choose to early adopt only certain provisions).

Disclosures

Under either approach, entities would disclose the following, as required by ASC 250:[2]

1. "The nature of and reason for the change in accounting principle."
2. "The cumulative effect of the change on the opening balance of retained earnings . . . as of the date of adoption."

The Board also noted that the "disclosure in (1) and (2) should be provided in each interim and the annual financial statement period in the year of the change."

---

[1] Quoted text is from the March 23, 2016, tentative Board decisions.

[2] FASB Accounting Standards Codification Topic 250, *Accounting Changes and Error Corrections*.

Further, an entity applying the full retrospective approach would disclose:

1. "A description of the prior-period information that has been retrospectively adjusted."
2. "The cumulative effect of the change on the opening balance of retained earnings . . . as of the earliest period presented."

In addition, the Board tentatively decided that for periods before the adoption date that are presented in the financial statements, entities would not be required to disclose:

1. "The basis adjustment amounts for fair value hedges."
2. "Qualitative information about quantitative goals."

Optional Elections

The Board tentatively decided that an entity could make the following one-time elections upon adoption:

1. *For existing hedging relationships* — To amend hedge documentation to specify whether subsequent effectiveness assessments will be performed qualitatively.
2. *For existing shortcut-method hedging relationships* — To amend hedge documentation to specify how the entity will quantitatively assess hedge effectiveness if it determines at a later date that use of the shortcut method is no longer appropriate.
3. *For existing hedging relationships that meet the criteria for designation of the variability in a contractually specified component as the hedged risk* — To "set the terms of the hypothetical derivative [used to measure ineffectiveness] to be at-market (that is, a fair value of zero) as of the original hedge inception date" (i.e., before the adoption date).

An entity may adopt any election it chooses — it does not have to adopt all the elections as a single package. An entity that elects (1) or (2) above must do so by "the end of the first fiscal year after the adoption date." The third election must be made "on or before the first quarterly hedge effectiveness assessment date after the adoption date."

Specific Considerations for Fair Value Hedges

The Board tentatively decided on transition guidance for the following two hedging relationships involving fair value hedges of interest rate risk:

- When an entity (1) dedesignates and immediately redesignates a fair value hedge of interest rate risk upon adoption and (2) changes the measurement method for the hedged item in a manner consistent with the proposed amendments, "the basis adjustment of the hedged item from the de-designated hedging relationship would be incorporated into the new hedging relationship. That is, an entity would adjust the cumulative basis adjustment recorded for the hedged item in the de-designated hedging relationship to reflect the basis adjustment that would have been recorded if the revised measurement methodology in the re-designated relationship had been used throughout the hedging relationship's life." These adjustments to the hedged items would be made through the opening balance of retained earnings upon adoption of the proposed amendments.

- When, upon adoption, an entity dedesignates a fair value hedge of the total price risk of a tax-exempt security and simultaneously redesignates the hedge to designate the hedged risk as the change in fair value attributable to fluctuations in the SIFMA[3] index rate, “the basis adjustment from the de-designated hedging relationship would be ‘frozen’ at the time of de-designation and manually amortized over the remaining life of the hedged item.”

Next Steps

At a future meeting, the FASB staff will present to the Board any additional matters it identifies during its drafting of the proposed Accounting Standards Update (ASU) as well as (1) its cost-benefit analysis, (2) a comment period for the proposed guidance, and (3) issues raised by external reviewers. The FASB expects to issue the proposed ASU in the second quarter of 2016.

---

[3] Securities Industry and Financial Markets Association.