effective offsetting changes in fair value or cash flows during the term of the hedge for the risk being hedged.

In making this decision, the FASB noted that a primary purpose of hedge accounting is to link items or transactions whose changes in fair values or cash flows are expected to offset each other. The FASB decided that one of the criteria for qualification for hedge accounting should focus on the extent to which offsetting changes in fair values or cash flows on the derivative and the hedged item or transaction during the term of the hedge are expected and ultimately achieved. *FAS 133, BOC – 230.*

95. Pursuant to the four cornerstones, as well as other components of the U.S. GAAP guidance, the provisions in this issue paper are not considered to be consistent with U.S. GAAP. Similar to SSAP No. 86, derivative instruments allowed to be considered part of an effective hedge under this issue paper, would not qualify to be considered part of an effective hedge under U.S. GAAP.

96. Key Elements of U.S. GAAP Guidance: (Only relevant excerpts are included.)

a. An entity shall recognize all of its derivative instruments in its statement of financial position as either assets or liabilities depending on the rights and obligations under the contracts. (815-10-25-1)

b. All derivative instruments shall be measured initially at fair value. (815-10-30-1)

c. All derivative instruments shall be measured subsequently at fair value. (815-10-35-1)

d. Forward contracts and purchased options within the scope of "Certain Contracts on Debt and Equity Securities" shall, at inception, be designated as held to maturity, available for sale, or trading in a manner consistent with the accounting prescribed for that category of securities. Such forward and option contracts are not eligible to be hedging instruments. (815-10-25-17)

e. Unless offsetting guidance is met (210-20-45-1), fair value of derivative instruments in a loss position shall not be offset against the fair value of derivative instruments in a gain position. (815-10-45-4)

f. An embedded derivative shall be separated from the host contract and accounted for as a derivative instrument if, and only if, the following criteria are met:

i. The economic characteristics and risks of the embedded derivative are not clearly and closely related to the economic characteristics and risks of the host contract.

ii. The hybrid instrument is not remeasured at fair value under otherwise applicable GAAP with changes in fair value reported in earnings as they occur.

iii. A separate instrument with the same terms as the embedded derivative would be a derivative instrument. (815-15-25-1)

g. 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 measuring effectiveness to achieve a desired accounting result. To qualify for hedge accounting, there shall be, at inception of the hedge, be formal documentation of specific elements. (815-20-25-3)

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h. An asset or liability is eligible for designation as a hedged item in a fair value hedge if all of the following additional criteria are met. (Only including key excerpts) (815-20-25-12)

   i. The hedged item presents an exposure to changes in fair value attributable to the hedged risk that could affect reported earnings.

   ii. If the hedged item is all or a portion of a debt security (or a portfolio of similar debt securities) that is classified as held to maturity in accordance with Topic 320, the designated risk being hedged is the risk of changes in its fair value attributable to credit risk, foreign exchange risk or both.

i. Gains and losses on fair value hedges shall be accounted for as follows: (815-25-35-1)

   i. The gain or loss on the hedging instrument shall be recognized currently in earnings.

   ii. The gain or loss (that is, the change in fair value) on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedging item and be recognized currently in earnings.

   If the fair value is fully effective, the gain or loss on the hedging instrument, adjusted for the component (if any) of that gain or loss that is excluded from the assessment of effectiveness under the defined risk management strategy for that particularly hedging relationship, is attributable to the hedged risk. Any difference that would arise would be the effect of hedge ineffectiveness, which consequently is recognized currently in earnings. (815-25-35-2)

**International Financial Reporting Standards**

97. Although International Financial Reporting Standards do not have guidance permitting effective hedge treatment as presented in this issue paper, the International Accounting Standards Board (IASB) is currently working on a similar project "*Accounting for Dynamic Risk Management: A Portfolio Revaluation Approach to Macro Hedging.*" In April 2014, the IFRS released a Discussion Paper as a first step in developing an accounting model for dynamic risk management.

98. The objectives of the IFRS project is to simplify and improve the usefulness of financial statements by developing accounting requirements for hedging within the context of open portfolios that are more closely aligned with a company's risk management activities. The IFRS identified, as a primary driver for initiating the project, the problems associated with applying hedge accounting, which is a fundamentally static concept (linking hedged instruments to hedged items) to dynamic risk management of open portfolios. As such, the IFRS decided to consider a new model for dynamic risk management of open portfolios.

99. The IASB is currently considering comments received on the exposed Discussion Paper, however, in reviewing project updates, it is anticipated that the IASB will re-issue a revised Discussion Paper for comment before even considering an exposure draft. (This is partly due to the original Discussion Paper focusing on interest rate risk management at banks, and commenters requested additional focus on the management of interest rate risk and other risks within non-bank entities.) As such, there is no expected timeframe for completion of this project at the IASB. This project is considered to be in the early stages, and it is anticipated to take a significant time before a standard is issued. In reviewing comments received by the IASB, some commenters included reference to insurance contracts, identifying that the need for a portfolio accounting model is needed to avoid accounting mismatches. These commenters supported the inclusion of hedged risks within insurance contracts being included in the IASB's dynamic risk management project.

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