Statement of Financial Accounting Standards No. 80

Note: This Statement has been completely superseded

FAS80 Status Page
FAS80 Summary

Accounting for Futures Contracts

August 1984

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 80

Accounting for Futures Contracts

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CONTENTS

Paragraph Numbers

Introduction and Scope 1– 2
Standards of Financial Accounting and Reporting:
Recognition of Changes in Market Value 3
Hedge Criteria 4
Hedges of Items Reported at Fair Value 5
Hedges of Existing Assets, Liabilities, and Firm Commitments 6– 8
Hedges of Anticipated Transactions 9–10
Ongoing Assessment of Correlation 11
Disclosure 12
Rescission of Technical Bulletin 13
Effective Date and Transition 14
Appendix A: Glossary 15
Appendix B: Examples of Application of This Statement 16–26
Appendix C: Background Information and Basis for Conclusions 27–71

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FAS 80: Accounting for Futures Contracts

FAS 80 Summary

This Statement establishes standards of accounting for exchange-traded futures contracts (other than contracts for foreign currencies). This project was undertaken to consider two AICPA Issues Papers that concern futures contracts and because the Board was aware of diversity in practice in accounting for futures contracts.

This Statement requires that a change in the market value of an open futures contract be recognized as a gain or loss in the period of the change unless the contract qualifies as a hedge of certain exposures to price or interest rate risk. Immediate gain or loss recognition is also required if the futures contract is intended to hedge an item that is reported at fair value (which frequently will be the case for futures contracts used as hedges by investment companies, pension plans, and broker-dealers).

If the hedge criteria specified in this Statement are met, a change in the market value of the futures contract is either reported as an adjustment of the carrying amount of the hedged item or included in the measurement of a qualifying subsequent transaction. Enterprises are required to cease accounting for a contract as a hedge if high correlation of changes in the market value of the futures contract and the effects of price or interest rate changes on the hedged item has not occurred.

This Statement is effective for futures contracts entered into after December 31, 1984, with earlier application encouraged in financial statements that have not been previously issued.

INTRODUCTION AND SCOPE

1. This Statement establishes standards of financial accounting and reporting for **futures contracts,**[1] except for futures contracts for foreign currencies.[2] This Statement does not apply to forward placement or delayed delivery contracts and therefore does not prescribe or proscribe particular methods of accounting for such contracts.

2. The basic issue addressed in this Statement is how to account for a change in the market value of a futures contract. The general principle set forth in this Statement is that such a change

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is recognized in income when it occurs. However, for certain contracts, this Statement requires that the timing of recognition in income be related to the accounting for associated assets, liabilities, **firm commitments,** or transactions. Appendix B presents examples that illustrate the applicability of this Statement, and Appendix C contains background information and the basis for the Board's conclusions.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Recognition of Changes in Market Value

3. A change in the market value of a futures contract [3] shall be recognized as a gain or loss in the period of the change unless the contract meets the criteria specified in this Statement to qualify as a hedge of an exposure to price or interest rate risk. If the hedge criteria are met, the accounting for the futures contract shall be related to the accounting for the hedged item so that changes in the market value of the futures contract are recognized in income when the effects of related changes in the price or interest rate of the hedged item are recognized.

Hedge Criteria

4. In applying this Statement, both of the following conditions shall be met for a futures contract to qualify as a hedge:

a. *The item to be hedged exposes the enterprise to price (or interest rate) risk.* In this Statement, risk refers to the sensitivity of an enterprise's income for one or more future periods to changes in market prices or yields of existing assets, liabilities, firm commitments, or anticipated transactions. To meet this condition, the item or group of items intended to be hedged must contribute to the price or interest rate risk of the enterprise.[4] In determining if this condition is met, the enterprise shall consider whether other assets, liabilities, firm commitments, and anticipated transactions already offset or reduce the exposure.[5] An enterprise that cannot assess risk by considering other relevant positions and transactions for the enterprise as a whole because it conducts its risk management activities on a decentralized basis can meet this condition if the item intended to be hedged exposes the particular business unit that enters into the contract.

b. *The futures contract reduces that exposure and is designated* [6] *as a hedge.* At the inception of the hedge and throughout the hedge period, high correlation of changes in (1) the market value of the futures contract(s) and (2) the fair value of, or interest income or expense associated with, the hedged item(s) shall be probable [7] so that the results of the futures contract(s) will substantially offset the effects of price or interest rate changes on the exposed item(s). In addition to assessing information

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about the correlation during relevant past periods, the enterprise also shall consider the characteristics of the specific hedge, such as the degree of correlation that can be expected at various levels of higher or lower market prices or interest rates. A futures contract for a commodity or a financial instrument different from the item intended to be hedged may qualify as a hedge provided there is a clear economic relationship between the prices of the two commodities or financial instruments, and provided high correlation is probable.

Hedges of Items Reported at Fair Value

5. If an enterprise includes unrealized changes in the fair value of a hedged item in income, a change in the market value of the related futures contract shall be recognized in income when the change occurs. The same accounting shall be applied to a futures contract that hedges an anticipated transaction if the asset to be acquired or liability to be incurred will be reported at fair value subsequent to acquisition or incurrence. Some enterprises report assets at fair value but include unrealized changes in that value in a separate component of stockholders' (or policyholders') equity pending sale or other disposition of the assets. A change in the market value of a futures contract that qualifies as a hedge of those assets also shall be included in that separate component of equity until sale or disposition of the assets unless paragraph 11 requires earlier recognition of a gain or loss in income because high correlation has not occurred.

Hedges of Existing Assets, Liabilities, and Firm Commitments

6. A change in the market value of a futures contract that qualifies as a hedge of an existing asset or liability shall be recognized as an adjustment of the carrying amount of the hedged item. A change in the market value of a futures contract that is a hedge of a firm commitment shall be included in the measurement of the transaction that satisfies the commitment. An enterprise may recognize the premium or discount on a hedge contract in income over the life of the contract if the commodity or financial instrument being hedged is deliverable under the terms of the futures contract, and if it is probable that both the hedged item and the futures contract will be retained to the delivery date specified in the contract. The premium or discount is computed at the inception of the hedge by reference to the contracted futures price and the fair value of the hedged item.

7. Recognition in income of the adjustment of the carrying amount of an asset or liability required by paragraph 6 shall be the same as other components of the carrying amount of that asset or liability.[8] An adjustment of the carrying amount of a hedged interest-bearing financial instrument that is otherwise reported at amortized cost shall be amortized as an adjustment of interest income or interest expense over the expected remaining life of the instrument. That amortization shall commence no later than the date that a particular contract is closed out, whether that contract is replaced by a similar contract for later delivery or not.

8. Some enterprises (for example, commodity dealers) may use futures contracts to hedge a

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net exposure comprising inventory held for sale and firm commitments to purchase and sell essentially similar assets. If associating individual futures contracts with the assets on hand or specific commitments is impractical because of the volume and frequency of transactions, reasonable allocations of the results of futures contracts between assets or commitments on hand at the end of a reporting period and assets sold during the period may be used. The method of allocation shall be consistent from period to period.

Hedges of Anticipated Transactions

9. A futures contract may relate to transactions (other than transactions *involving existing* assets or liabilities, or transactions necessitated by *existing* firm commitments) an enterprise expects, but is not obligated, to carry out in the normal course of business. A change in the market value of a futures contract that hedges the price or interest rate of such an anticipated transaction shall be included in the measurement of the subsequent transaction if the two conditions in paragraph 4 *and* both of the following conditions are met:

a. *The significant characteristics and expected terms of the anticipated transaction are identified.* The significant characteristics and expected terms include the expected date of the transaction, the commodity or type of financial instrument involved, and the expected quantity to be purchased or sold. For transactions involving interest-bearing financial instruments, the expected maturity of the instrument is also a significant term.
b. *It is probable that the anticipated transaction will occur.* Considerations in assessing the likelihood that a transaction will occur include the frequency of similar transactions in the past; the financial and operational ability of the enterprise to carry out the transaction; substantial commitments of resources to a particular activity (for example, a manufacturing facility that can be used in the short run only to process a particular type of commodity); the length of time to the anticipated transaction date; the extent of loss or disruption of operations that could result if the transaction does not occur; and the likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (for example, an enterprise that intends to raise cash may have several ways of doing so, ranging from short-term bank loans to common stock offerings). Enterprises sometimes may determine that two or more approximately similar alternative transactions are equally likely to occur. For example, a financial institution that plans to issue short-term obligations at a particular future date may have the choice of issuing various types of such obligations in domestic or foreign markets. In such cases, futures contracts are not precluded from qualifying as a hedge if all hedge criteria are met regardless of which transaction will be undertaken.

10. The accounting for a futures contract that hedges an anticipated acquisition of assets or an anticipated issuance of liabilities shall be consistent with the enterprise's method of accounting for those types of assets or liabilities. For example, a loss shall be recognized for a futures contract that relates to an anticipated inventory purchase to the extent there is evidence that the amount will not be recovered through sales. If a futures contract that has been accounted for as a

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hedge is closed before the date of the anticipated transaction, the accumulated change in value of the contract shall continue to be carried forward (subject to the other considerations in this paragraph and paragraph 11) and included in the measurement of the related transaction. A pro rata portion of the futures results that would otherwise be included in the measurement of a subsequent transaction shall be recognized as a gain or loss when it becomes probable that the quantity of the anticipated transaction will be less than that originally hedged.

Ongoing Assessment of Correlation

11. An enterprise regularly shall assess the results of a futures contract designated as a hedge to determine if the high correlation required by paragraph 4(b) is being achieved. If that assessment indicates high correlation has not occurred, the enterprise shall cease to account for the futures contract as a hedge and shall recognize a gain or loss to the extent the futures results have not been offset by the effects of price or interest rate changes on the hedged item since inception of the hedge. If the effects of price or interest rate changes on the hedged item are not readily determinable by reference to quoted market prices or rates, reasonable estimates may be used.

Disclosure

12. An enterprise that has entered into futures contracts that have been accounted for as hedges shall disclose (a) the nature of the assets, liabilities, firm commitments, or anticipated transactions that are hedged with futures contracts and (b) the method of accounting for the futures contracts. The disclosure of the method shall include a description of the events or transactions that result in recognition in income of changes in value of the futures contracts.

Rescission of Technical Bulletin

13. FASB Technical Bulletin No. 81-1, *Disclosure of Interest Rate Futures Contracts and Forward and Standby Contracts,* is rescinded.

Effective Date and Transition

14. The standards of financial accounting and reporting established by this Statement shall be effective for futures contracts entered into after December 31, 1984. Earlier application for futures contracts entered into during periods for which financial statements have not been issued is encouraged. The provisions of this Statement may be, but are not required to be, applied prospectively to all futures contracts open when this Statement is first adopted. Disclosures required by paragraph 12 shall be made in financial statements for periods ending after December 15, 1984 for open futures contracts designated as hedges whether the other provisions of this Statement have been applied to those contracts or not.

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The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Mr. Lauver dissented.

Mr. Lauver dissents from this Statement because of the exception in paragraph 4(a), which permits some enterprises that conduct their risk management activities on a decentralized basis to follow hedge accounting without demonstrating that risk of the enterprise as a whole has been reduced. The cornerstone of the hedge accounting provisions of the Statement is the condition that enterprise risk be reduced. The exception would be appropriate, in Mr. Lauver's view, only under the assumption that the business unit that enters into the futures contract has risk of the same nature as the enterprise as a whole, an assumption that would not always be correct. To base the accounting on an arbitrarily assumed factual state without evidence that that is the factual state constitutes, he believes, abandonment of the essence of the hedge accounting provisions of the Statement. The exception permitted in paragraph 4(a) may result in a futures contract being accounted for as a hedge even though, as a result of that contract, risk of the reporting enterprise has been increased rather than reduced. When there is no knowledge of the nature and extent of risk existing within the enterprise as a whole, Mr. Lauver believes there is no basis for departing from the general method of accounting for futures contracts stated in paragraph 3.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
Victor H. Brown
Raymond C. Lauver
John W. March
David Mosso
Robert T. Sprouse

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Appendix A: GLOSSARY

15. This appendix defines certain terms that are used in this Statement.

Financial Instrument

The term is used broadly in this Statement to include instruments usually considered to be securities (such as notes, bonds, debentures, and equities) as well as other evidences of indebtedness (such as money market instruments, certificates of deposit, mortgages, and commercial paper) that often are not referred to as securities.

Firm Commitment

An agreement, usually legally enforceable, under which performance is probable because of sufficiently large disincentives for nonperformance.

Futures Contract

A legal agreement between a buyer or seller and the clearinghouse of a futures exchange. The futures contracts covered by this Statement include those traded on regulated futures exchanges in the United States and contracts having similar characteristics that are traded on exchanges in other countries. Futures contracts covered by this Statement have the following characteristics: (a) They obligate the purchaser (seller) to accept (make) delivery of a standardized quantity of a commodity or financial instrument at a specified date or during a specified period, or they provide for cash settlement rather than delivery,[9] (b) they effectively can be canceled before the delivery date by entering into an offsetting contract for the same commodity or financial instrument, and (c) all changes in value of open contracts are settled on a regular basis, usually daily.

Appendix B: EXAMPLES OF APPLICATION OF THIS STATEMENT

16. This appendix presents examples that illustrate the application of this Statement. The examples do not address all possible uses of futures contracts. The facts assumed are illustrative only and are not intended to modify or limit in any way the provisions of this Statement. For simplicity, commissions and other transaction costs, initial margin (except in Example 1), and income taxes are ignored.

Example 1: Nonhedge Contract

17. On September 15, 19X4, B Company purchases 10 March 19X5 U.S. Treasury bill (T-bill) futures contracts at 87.50 as an investment. (Each contract is for a three-month $1,000,000 face amount T-bill.) On that date, B Company makes an initial cash margin deposit

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of $30,000 with its broker. B Company holds the contracts through November 15, 19X4, when it closes out all contracts. The quoted market price of March 19X5 T-bill contracts increases during September (to 88.00) and October (to 88.20) and declines in November (to 87.80 by November 15). B Company withdraws some funds from its margin account at various times in September and October, deposits additional funds in November to meet margin calls, and withdraws the entire balance in its account when the futures position is closed out. Changes in the company's margin account are summarized below.

	September	October	November
Beginning balance	$ 0	$32,500	$31,500
Deposit initial margin	30,000		
Change in the market value of the futures contracts[a]	12,500	5,000	(10,000)
Payments to (withdrawals from) account	(10,000)	(6,000)	8,500
Withdrawal of initial margin			(30,000)
Ending balance	$ 32,500	$31,500	$ 0

[a]Each basis point change in the price of a T-bill futures contract is equal to a $25 change in value. The gain for September is computed as follows:

September 30 price	88.00
September 15 price	87.50
	50 basis points
	x $ 25
	$ 1,250
Number of contracts	x 10
	$12,500

18. B Company's financial statements for the months ended September 30 and October 31 would show $32,500 and $31,500, respectively, due from its broker. (If B Company satisfied the initial margin requirements by depositing government securities, such as T-bills, rather than cash, the securities would not be classified as part of the balance due from the broker.) Gains of $12,500 for September and $5,000 for October and a loss of $10,000 for November would be recognized. The income statement display of the gains and loss would be consistent with how the company reports other investment gains and losses.

Example 2: Hedge of an Anticipated Purchase

19. On November 1, 19X3, C Company, an enterprise that produces a grain-based industrial product, determines that it will require 100,000 bushels of the necessary grain in the last week of February 19X4. The finished product is not sold forward under fixed-price contracts but is sold at the going market price at the date of sale. Market conditions indicate that finished product selling prices are not likely to be affected significantly during the next few months by changes in

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the price of the grain during that period. On November 1, the enterprise purchases 20 March 19X4 futures contracts (each contract is for 5,000 bushels of the grain) at $3.00 per bushel. On December 31, 19X3, the enterprise's fiscal year-end, the closing price of the March 19X4 contract is $2.80 per bushel. On February 24, 19X4, the enterprise purchases 100,000 bushels of the grain through its normal commercial channels and closes out the futures contracts at $3.10 per bushel.

20. The changes in the value of the contracts during 19X3 and 19X4 are as follows:

	November 1– December 31, 19X3	January 1– February 24, 19X4
Futures price at beginning of period	$ 3.00	$ 2.80
Futures price at end of period	2.80	3.10
Change in price, per bushel	(0.20)	0.30
Bushels under contract (20 contracts @ 5,000 bushels each)	x 100,000	x 100,000
	$(20,000)	$ 30,000

Unless this transaction qualifies as a hedge, C Company would report a $20,000 loss for the period ending December 31, 19X3 and a $30,000 gain in 19X4.

21. If, however, the hedge conditions in paragraphs 4 and 9 are met and evidence at December 31 indicates the $20,000 will be recovered on sale of the finished product, the enterprise would not recognize a loss in its 19X3 financial statements. On February 24, 19X4, the cumulative change in the market value of the contracts is a $10,000 increase ($20,000 decline to December 31, 19X3 plus $30,000 appreciation in 19X4). That amount would be shown as a reduction of the cost of the grain acquired.

Example 3: Hedge of Financial Instruments Held for Sale

22. M Company, a mortgage banking enterprise, holds $10 million of mortgage loans that will be packaged and sold as mortgage-backed securities. M Company is exposed to the risk that interest rates will rise (and, thus, the value of the mortgages will fall) before the securities are sold. On April 1, 19X4, the enterprise sells June 19X4 futures contracts for mortgage-backed securities. Interest rates decline in April and increase in May, resulting in a $520,000 unfavorable change in the market value of the futures in April and a $940,000 favorable change in May.

23. The futures contracts qualify as a hedge of the mortgage loans if both conditions in paragraph 4 are met. If those hedge conditions are met, and as long as the correlation required in paragraph 4(b) is being achieved, the mortgage banker would adjust the carrying amount of the mortgages for changes in the market value of the futures contracts. The carrying amount of the

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mortgages in M Company's financial statements would be as follows:

	April	May
Mortgages, beginning of period	$10,000,000	$10,520,000
Adjustment for futures results	520,000	(940,000)
Mortgages, end of period[a]	$10,520,000	$ 9,580,000

[a]Paragraph 4 of FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities,* requires mortgage banking enterprises to report mortgage loans held for sale at the lower of cost or market. Therefore, if the market value of the mortgages is less than the carrying amounts shown, a valuation allowance would be necessary.

24. If M Company decides to transfer the mortgage loans to a long-term investment classification on May 31 rather than sell the assets, the mortgages would be transferred at the lower of their new cost basis ($9,580,000) or market value, in accordance with FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities.* The difference between that amount and the outstanding principal balance would be amortized to income over the estimated remaining life of the mortgages.

Example 4: Hedge of the Interest Expense Related to Short-Term Deposits

25. The interest rate paid by a financial institution on its money market deposit accounts is revised every month and is a function of the current yield for three-month T-bills. On September 1, 19X4, the institution sells 30 futures contracts for three-month T-bills for the purpose of offsetting changes in the rate paid on the accounts for the 6 months commencing October 1. At each date the money market accounts are repriced, the enterprise closes out five of the contracts originally sold on September 1.

26. Changes in the market value of the futures contracts would be reported in income as those changes occur unless the hedge criteria of this Statement are met. In this situation, the futures contracts would have to qualify as "anticipatory hedges" because they relate to subsequent transactions—the payment of interest on the deposit accounts—that are not certain to occur. Therefore, in addition to meeting the hedge conditions in paragraph 4, the institution would also have to satisfy the conditions in paragraph 9 by demonstrating that it is probable that the deposits will be retained for the six-month period. Assuming the conditions in paragraphs 4 and 9 are met, changes in the value of the futures contracts would be reported as adjustments of interest expense. In this example, that would be accomplished by associating the change in value of the contracts closed with interest expense for the subsequent period. For example, changes in the market value of the contracts closed on October 1 would be amortized over the month of October as increases or decreases in interest expense on the deposits.

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Appendix C

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

	Paragraph Numbers
Introduction	27–30
Scope	31–34
Accounting at the Inception of the Contract	35
General Method of Accounting	36–39
Hedges	40–67
Hedge Criteria	42–48
Hedges of Existing Assets, Liabilities, and Firm Commitments	49–52
Hedges of Anticipated Transactions	53–57
Hedge Effectiveness	58–60
Financial Institutions	61–67
Disclosure	68–71

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Appendix C: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

27. In November 1980, the FASB issued for public comment an Exposure Draft of a proposed Statement, *Disclosure of Interest Rate Futures Contracts and Forward and Standby Contracts.* The letters received in response to the Exposure Draft pointed out that it would be difficult for enterprises to collect the required information. Because of the apparent implementation problems and because it wished to consider the advisory conclusions contained in a December 1980 AICPA Issues Paper, *Accounting for Forward Placement and Standby Commitments and Interest Rate Futures Contracts,* the Board decided not to issue a final Statement requiring the specific disclosures called for by the Exposure Draft. FASB Technical Bulletin 81-1 was issued in February 1981 to provide guidance for disclosure of accounting policies for futures and certain other contracts. That Bulletin is rescinded by this Statement, but the provisions of APB Opinion No. 22, *Disclosure of Accounting Policies,* continue to require the disclosures called for by the Bulletin for forward and standby contracts.

28. In November 1981, the Board added a project to its technical agenda to address the issues raised in the AICPA Issues Paper on interest rate futures contracts and, to the extent practicable, accounting for commodity futures contracts. Subsequently, the FASB received an AICPA Issues Paper, *Accounting by Agricultural Producers and Agricultural Cooperatives,* that indicated there was diversity among agricultural producers and agricultural cooperatives in accounting for futures contracts. The Board later expanded the scope of its project to include all futures contracts except foreign currency futures, which are already addressed by FASB Statement No. 52, *Foreign Currency Translation.*

29. An Exposure Draft of a proposed FASB Statement, *Accounting for Futures Contracts,* was issued on July 14, 1983. The Board received 153 responses to the Exposure Draft.

30. This appendix discusses the significant comments received on the Exposure Draft and the factors deemed significant by the Board in reaching the decisions in this Statement. It includes descriptions of the alternatives considered and the Board's reasons for accepting or rejecting them. Individual Board members gave greater weight to some factors than to others. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing and that the effective date and transition specified in paragraph 14 of this Statement are advisable in the circumstances.

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Scope

31. The scope of this Statement is the same as that in the Exposure Draft. Some respondents said that other contractual agreements, such as forward placement and option contracts, should be included because such contracts sometimes may be used—in either hedge or investment transactions—as alternatives to futures. Some of those respondents stated that excluding forwards or options could lead to dissimilar accounting for instruments that may affect the risk of an enterprise in essentially similar ways.

32. The Board believes that options and futures are different. Option holders acquire the right either to buy or to sell a commodity or financial instrument but have no obligation to do so; option writers have an obligation to sell or to buy the commodity or financial instrument if the buyer exercises the option. In contrast, futures contracts are "two-sided" in that buyers and sellers of futures both acquire a right and incur an obligation. Thus, the risk and return characteristics of options and futures are different, as is the system of margins in each market. The Board also notes that an AICPA task force currently is studying option accounting and plans to prepare an Issues Paper. In the absence of a compelling reason to do so, the Board believes it should not examine accounting for options at least until the task force has completed its Issues Paper.

33. The Board decided to exclude forward contracts from this project for two reasons. First, forwards differ from futures in at least some, and often all, of the following respects: amount and timing of cash flows, availability of liquid markets and reliable quoted prices, and potential for default. Second, forward contracts generally result in delivery of goods or services, whereas futures are almost exclusively hedging or investment vehicles. A large part of business activity is conducted by means of forward contracts. Although some forwards may be used as hedges and some may be entered into primarily as investments, most forward contracts are the traditional and accepted means by which enterprises carry out their normal commercial operations of purchasing and selling goods and services, issuing securities, making loans, and so forth. In the Board's view, it was neither necessary nor possible to deal with all such contracts in this Statement. To cover only a subset of those contracts (those that are judged on some basis to be "similar" to futures) would, in the Board's view, delay necessary guidance on accounting for futures and inevitably would result in an imprecise scope for the Statement.

34. Exclusion of forward contracts from the Statement should not be construed as either acceptance or rejection by the Board of current practice for such contracts, nor should the exclusion be interpreted as an indication that the general principles of this Statement might not be appropriate in some circumstances for certain forward contracts. At some future date, the Board may address the accounting for particular types of forward contracts, and it may address the conceptual aspects of accounting for executory contracts generally.

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Accounting at the Inception of the Contract

35. The Board considered and rejected requiring enterprises to recognize an asset and a liability for the total amount of the commodity or financial instrument that underlies a futures contract. Most, but not all, futures contracts give the holder of a long position the right to acquire a specified amount of a commodity or financial instrument at a particular date and obligate the contract holder to pay for those goods; the holder of a short position has the obligation to deliver goods and the right to receive payment. However, those rights may be exercised, and the obligations become firm, only if the enterprise holds the futures contract at the end of the last day of trading, a circumstance that rarely occurs. In addition, the individual rights and obligations related to delivery under a futures contract are similar to those embodied in most other fully executory contracts, which normally are not recognized in financial statements.

General Method of Accounting

36. Paragraph 3 of this Statement requires that a change in the market value of a futures contract that does not qualify as a hedge be recognized as a gain or loss in the period the change occurs. That accounting applies to futures contracts used for investment purposes and, as noted in paragraph 5, to hedging transactions of some enterprises, such as pension plans, investment companies, and broker-dealers, that currently recognize changes in the fair value of most assets in the period those changes occur. A few respondents objected to immediate gain or loss recognition for futures contracts that do not qualify as hedges. They said the Board should at least permit, if not require, a type of "lower of cost or market" accounting whereby net gains on futures contracts are recognized only when the contracts are closed. The arguments made in support of that accounting and the reasons the Board did not find them persuasive are summarized in paragraphs 37–39.

37. Some respondents stated that the daily cash settlements on open futures positions are not sufficient evidence that a gain has been realized. They said those settlements should be viewed as collateral or financing transactions, similar to margin arrangements for purchasing securities, that need not have an influence on income recognition. The Board disagrees with that position because, unlike purchasing securities on margin, buying or selling futures contracts does not involve loans. A favorable change in the market value of a futures contract enhances the enterprise's assets because the amount due from its broker is increased immediately. Amounts on deposit with a broker in excess of initial margin requirements can be, and frequently are, withdrawn in cash without closing out the futures contract. The Board does not believe such an increase in the assets of the enterprise results in a corresponding liability or a reduction of another asset.

38. Some respondents viewed the immediate recognition of gains on open futures contracts that are not hedges as an unwarranted departure from what they consider to be the general accounting framework in place today. In addition, a few cited FASB Statement No. 12,

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Accounting for Certain Marketable Securities, as support for using a lower-of-cost-or-market method for investments generally, and futures contracts specifically. The Board does not believe that holding a futures position is sufficiently similar to owning equity securities to conclude that the accounting set forth in Statement 12 applies. Statement 12 has a narrow scope (certain marketable equity securities owned by certain enterprises) and does not purport to establish accounting principles for all instruments that might be labeled "investments."

39. As noted in paragraph 59 of the December 1983 FASB Exposure Draft, *Recognition and Measurement in Financial Statements of Business Enterprises,* items currently reported in financial statements are measured by different attributes depending on the nature of the item and the relevance and reliability of the attribute measured. The Board believes the relevance and reliability of changes in the market value of futures contracts and the unique feature of futures trading—daily settlement of gains and losses—support recognizing gains on open contracts. Earnings of an enterprise that invests or speculates in futures contracts may fluctuate between periods as a result of applying the provisions of this Statement. The Board believes those reported results will provide relevant and understandable information to the users of the financial statements and will faithfully portray the economics of the transactions. In requiring recognition of gains and losses on open futures contracts, the Board is not changing present practice for other investments.

Hedges

40. Because of the unique features of futures trading, the effects of price or interest rate changes are realized as those changes occur. If enterprises use futures contracts to hedge assets, liabilities, or commitments for which unrealized changes in value are recognized in income, concurrent recognition of a gain or loss on the futures contract is also appropriate. Reported earnings will faithfully represent the economics of the hedge and will reflect the effectiveness of the enterprise's hedging practices. However, the effects of price or interest rate changes on most existing assets, liabilities, and firm commitments are not recognized in income until realized in a later transaction. To recognize gains or losses immediately for futures contracts that are intended to hedge such items could result in reporting related, offsetting amounts in income of different reporting periods. Such reporting would tend to increase variability in income, implying increased exposure to price or interest rate changes when, in fact, exposure to price or interest rate changes would have been reduced. A somewhat similar result would occur if gains or losses were recognized for futures contracts entered into in anticipation of probable transactions not involving existing assets, liabilities, or firm commitments.

41. This Statement recognizes the underlying economic effects of hedging activities by providing for delayed recognition in income of the changes in the market value of futures contracts that meet certain hedge criteria. The Board decided that the project should not consider any change in current accounting practices for assets, liabilities, or commitments generally. Thus, the Board restricted this project to considering methods of accounting for futures contracts that, given current accounting for hedged items, would better reflect the

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economic effects of hedging.

Hedge Criteria

42. The word *hedge* is used in a variety of ways by futures traders, accountants, and regulators, and there appears to be no generally accepted definition that is useful in making practical decisions. However, most, but not all, definitions are based on the notion of reducing exposure to price or interest rate risk. The Board concluded that risk reduction—that is, reducing the sensitivity of an enterprise's income to changes in prices or interest rates—should be the basis for delaying income recognition of the results of futures contracts.

43. Most respondents agreed that reduction of risk is an appropriate prerequisite for "deferral" accounting for futures contracts. However, several respondents disagreed with the Exposure Draft's proposal that other assets, liabilities, commitments, and transactions be considered in the assessment of whether a particular item contributes to exposure. Many of those respondents said that enterprises should be required to demonstrate only that price or interest rate risk is reduced on an individual item or transaction basis. The Board rejected that approach because it ignores the fact that some exposures already are hedged effectively by other positions of an enterprise. It could result in accounting for a futures contract as a hedge when the contract in fact *increases,* rather than reduces, the enterprise's exposure. For example, futures contracts used to "fix" the interest rate on variable-rate obligations could be considered a hedge if other positions of the enterprise are ignored. However, if the financial assets of the enterprise also have variable interest rates, the enterprise may expose itself to greater interest rate risk by entering into the futures contracts. If an enterprise chooses to assume greater risk via the futures markets, the Board believes that immediate recognition in income of the results of those futures transactions would provide relevant information for assessing the enterprise's performance.

44. The Board acknowledges that determining whether an exposure already is hedged effectively by another item sometimes may not be clear and may require judgment. The Board believes that such judgment is essential and must be exercised by those who have a thorough understanding of the enterprise's business and the specific circumstances. Detailed rules on how to assess risk might be perceived as providing comparability but would not be responsive to the complex and changeable risks faced by enterprises.

45. Some respondents stated that it could be impractical for some enterprises, particularly multinationals that operate in a decentralized manner, to comply with the "overall" risk assessment required in paragraph 4(a). Those respondents argued that hedge accounting should be permitted if the item to be hedged results in an exposure for the individual business unit that enters into the futures contracts. The shortcomings of a business unit approach to risk assessment are similar to, although much less severe than, those described in paragraph 43 for the strictly transactional approach. However, the Board notes that if an enterprise is unable to gather and disseminate information about relevant positions and transactions of the entire enterprise, condition 4(a) would require gains and losses on all future transactions of the

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enterprise to be reported in the period that futures prices change. In the Board's view, it is unlikely that such accounting would be a faithful representation of the extent to which the enterprise has modified its risk exposure. Therefore, although the "overall" approach to risk assessment is retained as the basic concept, the Board decided for practical reasons to permit risk to be assessed on a business unit basis when the decentralized nature of the enterprise's operations makes it impossible to consider other relevant positions and transactions of the entire enterprise.

46. Under the Exposure Draft, a futures contract that differed from the item intended to be hedged would meet the hedge condition on risk reduction only if it were not practicable to enter into a contract for the identical commodity or financial instrument. Comment letters indicate that respondents interpreted this "cross hedge" provision in a more restrictive manner than the Board intended. For example, some respondents thought the Exposure Draft proscribed hedge accounting unless a contract for the identical instrument was used even when that identical contract trades in volumes insufficient to make it a practical hedging vehicle. Paragraph 4(b), which differs from the Exposure Draft, now indicates that a futures contract for a different commodity or financial instrument may qualify as a hedge provided there is a clear economic relationship between the item underlying the contract and the item intended to be hedged, and provided high price correlation is probable.

47. One of the hedge criteria in the Exposure Draft was that unrealized changes in the fair value of the hedged item are not included, or are included only in certain circumstances, in the determination of income. A few respondents disagreed with that condition because they believed it implied that futures contracts intended to hedge items reported at fair value could not be legitimate hedges. The Board agreed with those comments and has revised the criteria to avoid that implication. The accounting, however, is unchanged.

48. The Exposure Draft distinguished between hedges (futures contracts used to reduce the risk caused by *existing* assets, liabilities, and firm commitments) and futures contracts related to certain anticipated transactions not involving existing assets, liabilities, or commitments. In this Statement, *hedge* refers to both uses of futures contracts. The Exposure Draft also contained separate risk exposure conditions for the two uses of futures contracts. This Statement requires that a single risk condition (paragraph 4(a)) be satisfied for any futures transaction for which hedge accounting is being contemplated. The revisions noted above were made to improve the understandability of the Statement and, in the Board's view, are not a change from the substance of the Exposure Draft.

Hedges of Existing Assets, Liabilities, and Firm Commitments

49. Some respondents recommended a method of accounting for certain hedge and arbitrage transactions that differed in some respects from the method proposed in the Exposure Draft. They indicated that the prices of certain futures contracts may reflect a full "carrying charge" (primarily to cover interest costs) over spot prices. Those respondents suggested that when an

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enterprise is "long" in the commodity or financial instrument and "short" in futures (or short in the commodity and long in futures), the difference between the futures price and the spot price at the inception of the hedge should be amortized to income over the life of the futures contract in a manner similar to that required in some cases by Statement 52 for foreign currency forward contracts.

50. The Board agreed with those respondents and concluded that in the conditions now specified in paragraph 6 an enterprise may account separately for the discount or premium identified at the inception of a contract that qualifies as a hedge. The Board notes that the net gain or loss (that is, the difference between results of the futures contracts and changes in the value of the hedged item) on such transactions will equal the identified premium or discount only if there is convergence of spot and futures prices by the delivery date of the futures contract. Therefore, paragraph 6 requires that the commodity or financial instrument involved be deliverable under the futures contract and that retention of both the spot and futures positions to the delivery date of the contract be probable. Relatively few hedges are likely to meet those conditions because most futures contracts are not held open up to the specified delivery date and because "cross hedges" will not qualify.

51. A few respondents, primarily financial institutions, suggested that changes in the market value of futures contracts deemed to be hedges should not be reported as adjustments of the carrying amount of the hedged items. They believe those amounts should be reported as "other" assets or liabilities, at least until the start of amortization, to avoid what were claimed to be distortions of the yield of the hedged item. As noted in paragraph 66, the Board believes futures contracts that hedge existing fixed-rate financial instruments effectively change the yield of those instruments. Separate presentation of such adjustments in the balance sheet would not reflect those changed yields. Thus, the Board did not adopt that suggestion.

52. A few respondents stated that a loss should be recognized on a futures contract that hedges an asset reported at cost if the adjusted carrying amount of the asset would be in excess of its fair value. If the carrying amount and fair value of the hedged asset are approximately equal at the inception of the hedge, the Board believes that the provisions of paragraph 11 of this Statement are adequate to ensure that the adjusted carrying amount and fair value of the hedged item will continue to be approximately the same. However, if the fair value is less than the carrying amount of the asset at the inception of the hedge, a fair value limitation on hedge adjustments effectively would preclude deferral of unfavorable futures results even when the hedge is fully effective. In the Board's view, the existence of the initial difference between the fair value and the carrying amount of the asset has no bearing on whether a hedge has been effective and should not influence the accounting for the hedge. Therefore, the Board decided that the fair value limitation suggested by some respondents was either unnecessary or inappropriate. This Statement does not, however, change any existing accounting requirements to report assets at the lower of cost or market.

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Hedges of Anticipated Transactions

53. Paragraph 9 of this Statement requires that changes in the value of certain futures contracts that qualify as hedges of anticipated purchase or sale transactions be included in the measurement of those transactions. For example, a banking enterprise that anticipates issuing certificates of deposit (CDs) to replace CDs that will mature at a particular time may sell interest rate futures contracts at an earlier date. If the market is demanding a higher yield on such instruments by the time the CDs are issued, the enterprise expects that the change in the market value of the futures contracts will be favorable and will, to some extent, offset the increased borrowing costs. Many view such contracts as a form of hedging, and the futures positions are often referred to as "anticipatory hedges." The Board understands that some enterprises use futures contracts as "anticipatory hedges" of sales of grain that is expected to be harvested at a later date, expected acquisitions of interest-bearing investments, expected purchases of inventory, and expected sales of metals that will be extracted and refined at a later date.

54. Although, in a technical sense, the anticipated transactions referred to in the preceding paragraph may not expose an enterprise to risk in the same way as existing assets, liabilities, or firm commitments, the Board believes there may be risk from a practical perspective. Gross margins of certain enterprises that have not established a price for anticipated purchases (for example, probable raw material requirements for the next six months) may be as exposed to price risk as the gross margins of enterprises in other industries that have not covered their firm fixed-price sales commitments. However, not all unpriced anticipated transactions involve risk for an enterprise, and, therefore, not all futures contracts that some may consider to be "anticipatory hedges" will meet the hedge criteria in paragraph 4. As noted in footnote 5 to paragraph 4(a), because of differences in the pricing structure of various industries, some enterprises become exposed to risk only through owning a commodity or when the price of a transaction becomes fixed; others in effect are exposed when they have not established the price for an anticipated transaction. It follows that some futures contracts related to anticipated transactions actually increase an enterprise's exposure and should not be accounted for as hedges. Ignoring fundamental differences in the risks to which different enterprises are exposed by prescribing hedge accounting for every contract related to an anticipated transaction would not produce reliable financial reporting of the results.

55. The "Notice for Recipients" accompanying the Exposure Draft asked respondents to comment specifically on the conditions proposed for a contract to qualify as a hedge of an anticipated transaction. Most comments pertained to the requirement that the anticipated transaction be sufficiently probable that "in the normal course of business, the enterprise has little discretion to do otherwise." Several respondents said that the Board should require only that the transaction's occurrence be *probable* because that term has support in current accounting literature unlike *little discretion,* which many respondents seemed to find confusing. Also, some respondents did not agree with a condition in the Exposure Draft that an anticipated transaction would not qualify if failure to carry out the transaction would result in little cost or disruption of

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operations. Most of those respondents agreed that the financial and other effects of not carrying out the transaction should be considered in assessing probability, but they stated it should not be an overriding condition. In addition, they noted that in some circumstances reliably measuring the cost of not doing something may be difficult or impossible.

56. The Board agreed with those respondents and modified paragraph 9(b); however, a high level of assurance that a transaction will occur is still necessary for the related futures contract to qualify as a hedge. As noted in the Exposure Draft, determination of the likelihood of a transaction's taking place should not, in the Board's opinion, be based solely on management's stated intent because that is not verifiable. Probability should be supported by observable facts and the attendant circumstances. The Board believes that the likelihood of a transaction's taking place can be supported by the frequency of similar past transactions, irreversible commitments of resources to a particular use, and other factors discussed in paragraph 9(b).

57. A few respondents interpreted the requirement to identify the anticipated transaction to be unduly restrictive. They believed the Exposure Draft would require identification of *specific* dates and quantities for the condition to be met; they recommended that the condition be broadened to require only that the amount of futures contracts be reasonably related to quantities of commodities or financial instruments that can be used, sold, or issued in the normal course of business over a reasonable period. The purpose of requiring identification of the significant terms is threefold. First, without some idea of the timing and amount of the anticipated transaction, it is impossible to assess whether there is price or interest rate risk (paragraph 4(a)). Second, the information is also necessary to assess the likelihood that the transaction will occur (paragraph 9(b)). Third, unless the expected terms of the transaction can be reasonably identified, it is unlikely that the correlation condition (paragraph 4(b)) can be met. Because the circumstances of each enterprise are different, the information needed to satisfy those three purposes may vary. In the Board's view, paragraph 9(a) does not preclude the use of reasonable estimates, such as estimates of dates and quantities, if the risk, probability, and risk reduction conditions can be satisfied. Therefore, the Board did not change the requirement in that paragraph.

Hedge Effectiveness

58. Under the Exposure Draft, a gain or loss would have been recognized to the extent that futures contracts were not effective as a hedge of an existing asset, liability, or firm commitment. The Exposure Draft also indicated that effectiveness might be assessed by comparing the change in the market value of the futures contracts and the unrecognized changes in the fair value of the hedged item since inception of the hedge. Paragraph 11 of this Statement differs somewhat from the Exposure Draft in that it requires an enterprise to discontinue accounting for a futures contract as a hedge if a high degree of correlation has not been achieved. When that occurs, paragraph 11 also requires recognition of a gain or loss to the extent the futures results have not been offset by the effects of price or interest rate changes on the hedged item.

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59. Most respondents objected to the proposed requirement for an ongoing assessment of hedge effectiveness. Many claimed that the initial assessment of whether risk would be reduced (paragraph 4(b)) was a sufficient condition for continuation of hedge accounting. The Board did not concur with that view. Paragraph 4(b) requires that it be *probable* that changes in the market value of the futures contract(s) will offset the effects of price or interest rate changes on the hedged item. In many cases the actual results of a hedge transaction may be approximately what was expected. However, even though high correlation may be probable at inception, it is not certain; actual price relationships over the hedge period may be significantly different from what was expected. Several respondents confirmed that fact. The Board concluded that the continuation of hedge accounting must be justified by what has actually happened rather than on the basis of expectations formed at an earlier date.

60. The Exposure Draft's lack of an explicit effectiveness test for "anticipatory hedges" was mentioned by several respondents, who stated that such an omission resulted in an inconsistency in the document. The Board agreed with those comments; the ongoing review of correlation required by paragraph 11 applies both to hedges of existing positions and to hedges of anticipated transactions. Many respondents also said that the cost of complying with the effectiveness test proposed in the Exposure Draft could be high and generally would not be justified by the resulting benefits. In addition, several other respondents commented that estimates of the changes in the fair value of hedged items frequently are too unreliable to use as a basis for gain or loss recognition. The Board decided that the requirement in paragraph 11 would be a less costly and more easily implemented method of assessing effectiveness.

Financial Institutions

61. A financial institution may be exposed to interest rate risk when its assets and liabilities have different repricing or maturity characteristics. For example, a bank that owns primarily long-term fixed-rate loans receivable and that has issued primarily short-term obligations may be exposed to the risk of rising interest rates. Financial institutions that use futures contracts to reduce that risk may sell interest rate futures contracts. There are several different views about how such an institution should account for those contracts. One view is that the short futures positions are hedges of a portion of the loans receivable (assuming the necessary degree of price correlation is probable). Another view is that the futures contracts relate to the rollover or replacement of some of the short-term obligations (again assuming the necessary correlation is probable). Others maintain that the contracts need not necessarily be related to identifiable assets or obligations but instead should be considered "general" or "macro" hedges of the enterprise's net exposure. Comment letters from some financial institutions expressed a variation of those views; they consider the futures contracts to be a hedge of the interest margin ("spread") for a particular period determined by reference to the repricing characteristics of specified assets and liabilities.

62. This Statement permits futures contracts that reduce interest rate risks of financial institutions to qualify as hedges of either existing positions (the loans in the example in the

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preceding paragraph) or anticipated repricings or replacement of particular instruments (the short-term obligations in the preceding paragraph) provided the hedge criteria are met for the strategy selected. The Board concluded that hedge accounting should not be permitted for so-called macro hedges where the futures contracts are not linked with identifiable assets, obligations, commitments, or anticipated transactions. Without such linkage, there is no objective method of either gauging the effectiveness of the futures contracts or ultimately recognizing the futures results in income. The Board also did not adopt the suggestion that futures contracts be considered hedges of the interest spread between specifically identified assets and liabilities. The Board views the association of an asset with a specific funding source as an arbitrary process. Moreover, interest spreads per se cannot be hedged directly; there are no futures contracts for interest spreads. Clearly, the intent of the institution may be to reduce uncertainty about future interest spreads, but that is accomplished with futures by changing the revenue or expense component of the spread through hedges of existing or anticipated asset or liability positions.

63. The Board understands that the determination and measurement of the interest rate risk of a financial institution may be complex and may involve significant estimates and judgments. The Board considered providing more specific guidance concerning when the risk condition in paragraph 4(a) is met by financial institutions but concluded that it was not feasible to do so at present. The analysis and determination of an institution's interest rate sensitivity (and compilation of the necessary information) is, the Board understands, an evolving process, and the approach followed may vary from institution to institution. It was noted that there is not a consensus among bankers and others about whether "gap" analysis, duration analysis, or some other method is the most appropriate way of assessing risk. The Board concluded that it should not attempt at this time to specify a single measure of interest rate sensitivity for use in applying the provisions of this Statement.

64. A few respondents questioned whether the hedge criteria could be met for a futures contract intended to hedge a fixed-rate financial instrument that an institution plans to hold to maturity. They argued that instruments held as long-term investments and reported at cost do not expose the enterprise to price or interest rate risk. Those respondents acknowledged that interest rate risk could exist because such assets may be funded by shorter-term liabilities; in that case, those respondents would support hedge accounting only for futures contracts related to the replacement or repricing of the shorter-term liabilities. The Board considered those comments and concluded that a futures contract should not be precluded from qualifying as a hedge solely because the enterprise plans to hold a fixed-rate financial instrument (asset or liability) to maturity; interest rate risk may exist irrespective of an institution's stated intention not to sell fixed-rate assets (or redeem fixed-rate liabilities) before maturity. Footnote 4 to paragraph 4(a) has been added to indicate when futures may qualify as hedges of such instruments.

65. The Exposure Draft proposed that adjustments to the carrying amount of hedged fixed-rate financial instruments referred to in the preceding paragraph be amortized over the remaining life of the instrument beginning at the termination of the hedge. Comment letters contained many

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conflicting views about when amortization should commence and over what period. Some respondents would relate the amortization to the repricing date of a liability that was deemed to fund the hedged asset (or the repricing date of an asset that was deemed to be funded by the hedged liability). Most of those respondents would determine the amortization period at the inception of the hedge and subsequently would not change the start or length of that period. Other respondents argued that it was inappropriate to delay amortization until hedge termination because lengthy periods could elapse before any futures results were recognized in income. Also, a few respondents claimed that the remaining life of the hedged item could be too long a period over which to amortize hedge adjustments. Other respondents also asked the Board to clarify whether a "rollover" of a contract (closing out a contract and replacing it with a similar contract for a more distant delivery month) results in termination of a hedge and whether the start of amortization could be delayed if a hedge is continued by using instruments other than futures.

66. The Board believes that the results of hedging the fixed-rate instruments referred to in paragraph 64 can be viewed as an adjustment of the yield on the instrument over its expected remaining life. If there is an unfavorable change in the value of a futures contract that hedges such a fixed-rate asset, the carrying amount of the asset increases, and the effective yield on that instrument is lower. Conversely, favorable futures results can be viewed as increasing the asset's yield. The Board believes it is reasonable to recognize the changed yield over the life of the instrument. To relate income recognition to a specific liability that is deemed to fund the asset is inconsistent with the notion that the futures contracts are used to change the asset's yield. And, as noted earlier, the Board believes that associating an asset with a specific funding source is an essentially arbitrary process and should not be the basis for amortization.

67. In concept, amortization should commence as soon as the futures contracts change in value. However, such a process would usually be cumbersome because the amount of the hedge adjustment changes daily as the price of open futures contracts changes. Paragraph 7 of this Statement now requires that amortization commence no later than the date a particular contract is closed (whether it is "rolled over" or not). That approach is relatively simple and eliminates the uncertainty that would be introduced if the start of amortization depended on when the hedging strategy, as opposed to a particular contract, is terminated. It also eliminates the possibility that amortization could be delayed for extended periods merely because a hedge has not been terminated. Paragraph 7 also differs from the Exposure Draft in that the amortization period is now the *expected* remaining life, rather than the stated maturity, of the hedged instrument. The Board made that change in response to comments that the actual remaining life of some instruments (for example, Government National Mortgage Association mortgage-backed securities) may be less than their stated maturity.

Disclosure

68. Under this Statement, the method of accounting for a particular futures contract depends on the circumstances. A futures contract could be an investment for one enterprise; a hedge of

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an existing asset, liability, or firm commitment for another; and an "anticipatory hedge" for a third. In addition, the accounting for futures contracts that are hedges will vary depending on the nature of the hedged items. The Board concluded that disclosure of the method(s) of accounting for futures contracts that qualify as hedges and the nature of the hedged items is necessary in such circumstances.

69. The Exposure Draft was accompanied by a "Notice for Recipients" that asked for specific comments on whether additional disclosures should be required. The Exposure Draft outlined three possible additional disclosures: the amount of futures contracts outstanding at the end of a reporting period, futures results recognized in income during a period, and the amount of futures results "deferred" at the end of a period. Most respondents restricted their comments to just those items and generally were not in favor of additional disclosures. The Board decided not to require additional disclosures for the reasons cited in the following paragraphs.

70. Some respondents recommended disclosure of the amount of futures contracts outstanding at the end of an accounting period because they believe it could help financial statement readers assess the extent to which an enterprise is either insulated from or exposed to the effects of subsequent price or interest rate changes. Knowledge about the degree to which an enterprise has reduced or has increased risk exposure may help financial statement users estimate the probable effects of subsequent price changes on the enterprise's earnings and its possible performance relative to other enterprises in the same industry. The Board concluded that the amount of futures contracts outstanding at a particular time is a very crude and possibly misleading measure of risk exposure or hedging activity. The number of contracts outstanding may vary considerably over time because of seasonal or other temporary changes in the enterprise's business, changes in interest rates and prices, changes in the enterprise's hedging policy, decisions to invest in instruments other than futures, and other factors. Also, because buying and selling futures contracts is a relatively simple and inexpensive procedure, the amount of contracts outstanding at the end of a period could easily be manipulated.

71. The Exposure Draft pointed out that some support disclosure of the income effects of using futures because they believe such transactions are a separable and discretionary activity of an enterprise. Some respondents disagreed with that position and noted that hedging with futures may be an integral part of the business. Others claimed that the effect of hedging with futures was no more noteworthy than the effects of the many other discretionary activities of a business, which often are not separately disclosed in financial statements. Some respondents also pointed out that disclosure of offsetting changes in the items being hedged would be necessary to make the futures disclosures not misleading and that such disclosures typically are not required for items that are not hedged. The Board agreed and decided not to require disclosure of the income effects. For similar reasons, the Board decided not to require disclosure of the changes in the value of futures contracts that have yet to be recognized in income.

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Footnotes

FAS80, Footnote 1--Terms defined in the glossary (Appendix A) are in **boldface type** the first time they appear in this Statement.

FAS80, Footnote 2--The provisions of FASB Statement No. 52, *Foreign Currency Translation,* apply to accounting for foreign currency futures.

FAS80, Footnote 3--For purposes of this Statement, the change in the market value of a futures contract equals the change in the contract's quoted market price multiplied by the contract size. For example, the change in the market value of a $100,000 U.S. Treasury bond futures contract whose price moves from 80-00 to 78-00 is $2,000.

FAS80, Footnote 4--An interest-bearing **financial instrument** that an enterprise will retain to maturity does not, in and of itself, create interest rate risk if the instrument's interest rate is fixed. The amount of cash inflows or outflows is certain (assuming no default) and is not affected by changes in market interest rates. Notwithstanding that the cash flows associated with the instrument are fixed, the enterprise may be exposed to interest rate risk if it has funded its assets with instruments having earlier maturities or repricing dates. Futures contracts may qualify as a hedge of a fixed-rate financial instrument the enterprise intends to hold to maturity if the maturity or repricing characteristics of the instrument contribute to the enterprise's overall asset-liability mismatch.

FAS80, Footnote 5--For example, assets held for resale may subject the enterprise to price risk, but that risk already may be wholly or partially offset by firm fixed-price sales commitments. Floating-rate debt may result in interest rate risk for one enterprise but not for another because of differences in the maturity or repricing characteristics of the assets owned by each enterprise. As a further example, unpriced anticipated raw material requirements may be a risk in some industries because finished product and raw material prices do not move together. For other industries, such as commodity trading, an exposure to risk may exist only when the commodity is held or when there are firm fixed-price commitments.

FAS80, Footnote 6--One or more futures contracts may be designated as a hedge of either an individual item or an identifiable group of essentially similar items (for example, government securities that have similar maturities and coupon rates).

FAS80, Footnote 7--*Probable* is used here and in other parts of this Statement consistent with its use in FASB Statement No. 5, *Accounting for Contingencies,* to mean that a transaction or event is likely to occur.

FAS80, Footnote 8--For example, an adjustment of the carrying amount of a hedged asset held for sale usually would be recognized in income when the asset is sold. However, earlier recognition may be necessary if other accounting standards, for example, ARB No. 43, Chapter

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4, "Inventory Pricing," require that the adjusted carrying amount of the asset be written down to a lower amount.

FAS80, Appendix A, Footnote 9--Futures contracts for indexes of prices are considered to meet this condition even though there is no underlying commodity or financial instrument.

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