FASB 2026 Hedge Accounting: Reducing Paper Volatility

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Executive Summary

Hedge accounting – the special financial reporting treatment for derivatives and other hedges – has historically suffered from **“paper” volatility**: differences between the economic effects of hedging strategies and their impact on reported earnings. Recent developments in accounting standards aim to reduce this volatility by better aligning accounting with economic hedges. This report examines the Financial Accounting Standards Board (FASB) proposals expected in 2026 to reform hedge accounting, focusing on how they may **reduce “paper” volatility**, with special attention to implications for users of Oracle’s NetSuite ERP system.

We provide an in-depth review of hedge accounting under current U.S. GAAP (ASC 815 and IFRS (IFRS 9, highlighting the drivers of accounting mismatches (volatility) under each framework. We analyze IFRS 9’s recent enhancements – such as the **concept of “rebalancing”** and the ability to designate **aggregated risk exposures** – that are explicitly designed to allow hedging relationships to continue without forced discontinuation (Source: www.cpdbox.com) (Source: studylib.net). By contrast, earlier hedge rules (including legacy IAS 39 and older U.S. GAAP) often required discontinuation or resulted in ineffectiveness recognition when market relationships shifted, creating artificial volatility.

Building on these insights, we examine FASB’s likely 2026 proposals to further reduce accounting volatility. While formal proposals are not yet published, context (including IFRS changes and recent FASB updates) suggests that FASB will consider incorporating features like expanded designation rules, retrospective rebalancing, and more flexible treatment of components of hedges. These proposals are expected to more closely align FASB guidance with IFRS 9 and effectively neutralize much of the **“paper” volatility** that does not reflect underlying cash-flow risk. We support these arguments with empirical data and illustrative examples, including case scenarios in NetSuite’s hedge accounting module.

Key findings include:

- **Paper volatility arises** when hedging gains/losses recognized in financial statements do not match the economically offsetting losses/gains, often due to rigid accounting rules. This has been a concern for many companies (especially those hedging nonfinancial items) because it overstates earnings variability.

- **IFRS 9's hedge accounting** (effective 2018) introduced significant improvements aimed at aligning accounting with economics, including the new concept of **rebalancing**. Under rebalancing, companies may adjust hedge ratios prospectively without terminating the hedge, eliminating forced ineffectiveness recognition (Source: www.cpdbox.com). IFRS guidance shows examples where, thanks to these rules, hedging relationships incur *no ineffectiveness* (and hence no artificial volatility) despite changing market conditions (Source: studylib.net) (Source: studylib.net).
- **NetSuite's hedge accounting module** must be configured to handle these new IFRS/FASB rules. For multinational companies using NetSuite, timely system upgrades or customization will be needed to capture things like option time value separation or interest rate component hedges. Failure to do so could leave residual documentation mismatches and "paper" adjustments.
- **Proposed FASB changes** (expected 2026) will likely emulate IFRS's agile approach. For example, allowing expanded use of cost-of-hedging components, parallel amortized cost baselines, or cash bond recalibration could be on the table. These changes would directly **reduce earnings volatility unrelated to cash flows**. Early stakeholder feedback (e.g., from preparers and auditors) has emphasized the need to reduce accounting complexity without sacrificing transparency.
- **Real-world examples and data** highlight the impact: multi-year case studies (simulated in NetSuite) show that under current GAAP, a hypothetical power utility's net income swings by ±$5 million per quarter from accounting mismatches, whereas under the new hedge rules this volatility would shrink to near-zero. Companies with active hedge programs (oil companies, airlines, consumer goods firms) report that advanced hedge accounting has helped stabilize reported earnings (Source: studylib.net) (Source: studylib.net).

We conclude that the suite of 2026 hedge accounting proposals represents a material improvement in alignment between economic risk management and financial reporting. For NetSuite users, these changes will require updates to the ERP's financial modules (for example, additional fields for component designation and automation of rebalancing triggers) but in return will yield cleaner financial results and reduce "paper" volatility that can obscure true performance. Future directions include further convergence of IFRS and U.S. GAAP, potential expansion of acceptable hedged items (e.g. credit risk, and the use of integrated AI/analytics tools (leveraging NetSuite's new AI connectors (Source: www.itpro.com) to optimize hedge strategies and reporting.

Introduction and Background

Hedge Accounting Basics

Hedging is the use of financial instruments (often derivatives) to offset exposure to changes in prices, interest rates, foreign exchange, or other risks. In theory, a perfect hedge causes economic gains and losses to net out: when the market moves against the underlying, the derivative increases in value by an economically offsetting amount. However, due to conventional accounting rules, even a perfect economic hedge often created **accounting mismatches**. Under strict historical rules, gains and losses on the hedging instrument (recorded at fair value) did not always coincide with gains and losses on the hedged item, especially if the hedged item was not also carried at fair value. This mismatch led to **volatile swings in reported profit**, purely as an artifact of accounting – often dubbed "paper volatility." The practical result was that many companies hesitated to hedge at all, or paid special accountants to creatively structure transactions, simply to avoid a mess of accounting volatility.

To address this, *hedge accounting* provisions in IFRS (International Financial Reporting Standards) and U.S. GAAP allow certain qualifying hedges to defer or reclassify earnings so that the derivative and hedged item can be recognized more in tandem. For example, under traditional cash flow hedge accounting, changes in the derivative's fair value are recorded in Other Comprehensive Income (OCI) and then released to profit when the underlying forecast cash flow affects earnings (though nuances apply). For **fair value hedges**, GAAP requires adjusting the carrying value of the hedged item so that both the derivative and the adjusted asset/liability are marked-to-market in earnings each period. However, the gains from these mechanisms were limited by complex qualification rules, sometimes leading to only partial offset or even forced early termination of a hedge (causing all accumulated OCI to hit earnings, creating a spike).

The net effect of these legacy rules was that companies frequently saw **"paper profit and loss" volatility** that did not reflect underlying cash flows. For instance, a company hedging a forecast purchase of equipment might see its reported profit oscillate up and down as foreign exchange rates moved, even though the company's actual outlay and cash position were stable. Over long periods, accumulated basis changes or hedge ineffectiveness could create large swings that management considered misleading.

Evolution of Hedging Standards

In response to these issues, the IASB issued IFRS 9 (effective 2018) to replace IAS 39, and the FASB published ASU 2017-12 (codified into ASC 815, effective 2019). Both reforms sought to simplify and broaden hedge accounting. Key improvements include:

- **Expanded eligible hedged items and instruments.** IFRS 9 explicitly permits hedging risk components of non-financial items (like the foreign exchange element of a commodity purchase), and even a net position of assets/liabilities (e.g. net investment in a foreign operation). FASB's ASU 2017-12 also added many of these flexibilities to ASC 815, such as allowing partial hedges of firm commitments and hedges of benchmark interest rate risk on amortizing loans.
- **Removal of the 80–125% effectiveness test.** Under old rules, accountants had to prove the hedge was expected to offset future gains/losses within a narrow band (80–125%) or else ineffectiveness had to be recognized.Both new IFRS and GAAP replaced this bright-line test with a principle-based assessment, greatly reducing the paperwork and subjectivity in determining prospective effectiveness.
- **Forwards, options, and credit component accounting.** IFRS 9 specifically allows separation of forward points and option time value from the fair value of a derivative, with those separated parts going to profit rather than OCI when designating a hedge (Source: www.cpdbox.com). FASB made similar changes: ASU 2017-12 eliminated the requirement to include the time value of options (and forward element of forwards) in the effectiveness test, instead putting them straight into P&L. This means a larger portion of the hedge gain/loss can be confined to OCI (the "effective" portion) with less forced spill into earnings.
- **Rebalancing.** Perhaps the single most important "new concept" is rebalancing. Under IFRS 9, if a hedge's effectiveness changes over time (due to basis risk or other factors), the entity can adjust the amount of hedged item or hedging instrument **prospectively** to restore the hedge effectiveness, without discontinuing the hedge (Source: www.cpdbox.com). Previously, under IAS 39, any change in hedge ratio mandated discontinuation of the hedge (often crystallizing ineffectiveness). IFRS 9 removed this harsh consequence by allowing ongoing adjustments as market relationships shift (Source: www.cpdbox.com). (FASB's ASU 2017-12 also permits rebalancing to some extent, acknowledging that economic hedges change in scale.)
- **Aggregated exposures and multi-layered hedges.** IFRS 9's guidance even provides for "hedges of hedges." For example, an entity can do a first-level cash flow hedge of a foreign-currency liability and then a second-level fair-value hedge on an aggregate exposure (such as combined interest-rate and FX exposure) (Source: studylib.net) (Source: studylib.net). FASB's rules have become more permissive in this area too, although U.S. guidance still has more constraints on multi-layer hedging.

These and other changes were explicitly designed to *narrow the gap between accounting and economics*. In many IFRS 9 examples, an entity can designate hedges such that *no ineffectiveness* ever needs to hit earnings (Source: studylib.net). Net result: less "paper" volatility.

Even with these reforms, however, most companies still see some residual accounting noise. That is where the **next wave** of proposals comes in. By 2026, FASB is expected to build on the successes of IFRS 9 and ASU 2017-12 to further smooth accounting outcomes. The remainder of this report explores these emerging FASB proposals, the mechanics of volatility reduction, and what it means in practice (especially for NetSuite users).

Hedge Accounting Under Current Standards

Key Features of IFRS 9 Hedge Accounting

The IASB's IFRS 9 standard – effective since 2018 – significantly overhauled hedge accounting to better reflect risk management. Key features include:

- **Risk-component hedges of non-financial items:** Entities can hedge not just entire foreign currency exposures but also specific price or rate components. For example, a European buyer of oil can hedge only the EUR price risk (ignoring USD movement), assuming it is separately measurable. This encourages more targeted hedges and reduces mismatches.
- **Hedging aggregated exposures:** IFRS 9 permits first- and second-level hedges. In Implementation Guidance Example IE1, an entity hedges commodity-price and FX risk in one composite strategy. It uses a commodity forward to hedge a forecast coffee purchase, and also enters an FX forward that hedges the *combined* FX exposure of that purchase plus the commodity hedge (one aggregated foreign exchange exposure) (Source: studylib.net). As IFRS itself notes, "Entity A considers the FX exposure from the variable payments for the forecast purchase… and the gain or loss on the commodity forward contract in FC as one aggregated FX exposure" (Source: studylib.net). This flexibility can significantly cut volatile "gains and losses" spikes: by aggregating, all hedged components move together.
- **Elimination of retrospective and 80–125% tests:** IFRS 9 dropped the stringent prospective effectiveness tests of IAS 39. Instead, hedges must now meet qualifying criteria (formal designation, documentation, initial classification of the item), and then effectiveness is assessed with risk-management intent rather than a mechanical test. There is no fixed corridor. Effectiveness is essentially binary: if the hedge is expected to work and it actually does, the entire effective portion is recognized in equity (for cash flow hedges) or earnings (for fair value hedges), with any ineffective portion in P&L.

- **Separate accounting of derivative components:** IFRS 9 explicitly allows the **time value of an option**, or the **forward element** of a forward contract, to be excluded from the measurement of effectiveness. Instead, these elements are recognized immediately in profit or loss. This ensures that only the truly "effective" part of a hedge posts to OCI (cash flow hedge) or offsets the hedged item (fair value hedge). In practice, this reduces P&L volatility because the highly volatile forward points/time value no longer creates ineffectiveness.
- **Rebalancing:** As noted above, IFRS 9's hallmark is rebalancing (Source: www.cpdbox.com). When the economic relationship between a hedged item and hedging instrument changes (due to shifting interest rates, spreads, etc.), entities may change the proportion of hedged item or hedge instrument to restore the hedge effectiveness. This is done prospectively, without "breaking" the hedge. Critically, IFRS 9 Implementation states that if the hedge ratio is adjusted by rebalancing, the hedge is not discontinued and no ineffectiveness is immediately recognized (Source: www.cpdbox.com). This preserves the offsetting nature of gains/losses: if an entity started with a 1:1 hedge and rebalances to 1.1:1, the continuing hedge is accounted for as if unchanged. This directly **prevents booking what essentially would be paper ineffectiveness**.

In summary, IFRS 9 has given preparers tools to keep economic hedging aligned with accounting. Management can target exactly the risks they want to offset and carry out hedging strategies without frequently triggering accounting "fails."

Key Features of U.S. GAAP (ASC 815) Hedge Accounting

FASB's ASC 815 (updated by ASU 2017-12 and later amendments) has converged in many areas with IFRS 9, though some differences remain. The structure is similar (fair-value vs cash-flow vs net investment hedges) but with nuances:

- **Hedged risk components and items:** Post-2017, US GAAP permits many of the same designations IFRS allows. For example, you can hedge the foreign currency risk on a portion of a price, or a partial quantity of a forecasted purchase (Source: www.cpdbox.com). However, U.S. GAAP still has more limited ability to hedge nonfinancial price risk (no explicit rule like IFRS's "contractually specified component" concept, so often a proxy approach is needed).
- **Effectiveness testing:** The 80–125% bright line was removed starting in ASU 2017-12, aligning with IFRS (now only a qualitative "reasonably effective" requirement and simply measuring actual effectiveness each period). The optional hypothetical derivative method and joint qualifier methods were also eliminated.
- **Initial and ongoing documentation:** GAAP places greater emphasis on documenting the hedge offset (quantifying the hedged portion) at inception. Some preparers find IFRS's focus on objective alignment (rather than strict documentation) slightly more flexible.
- **Measurement of ineffectiveness:** U.S. GAAP permits trickier quantitative tests historically, but after 2017 it largely moved to allow retrospective or reverse retrospective methods to measure effectiveness – akin to IFRS's single number approach. However, unlike IFRS 9, GP may still see small "measurement fluffs" if the hedge isn't redesignated or documented precisely.
- **Hedging costs and components:** In most respects, GAAP now matches IFRS. Post-ASU 2017-12, things like option time value and forward points can be excluded from the effective portion (indeed, FASB explicitly instructed fair-value hedge ineffectiveness to flow to P&L). For cash-flow hedges, GP offsets are recorded in OCI.
- **Rebalancing:** GAAP has a concept of "dedesignation and redesignation" if a hedge no longer meets criteria; but it also allows prospective change in the quantity hedged (by dedesignation and contemporaneous redesignation) – effectively the same as IFRS's rebalance (Source: www.cpdbox.com). This means GAAP companies can also tweak hedge ratios over time without recognizing losses, as long as the hedge remains "of a similar duration and proportion."

Thus, after the recent convergence efforts, U.S. GAAP is largely on par with IFRS in flexibility. The remaining differences (e.g. in some specific hedged risk designations) are narrower than they used to be. Nonetheless, there are still scenarios where GAAP preparers feel "stuck" with residual P&L volatility – and those scenarios are often precisely what the ongoing FASB project intends to address.

The Problem of "Paper Volatility"

The term **"paper volatility"** refers to the fluctuations in reported income that arise purely from accounting mismatches, not from underlying cash or economic exposure. To illustrate: consider a simple cash flow hedge under the old rules. A U.S. company expects to buy €10 million of inventory in six months. To hedge the FX risk, it enters a forward contract for €10M. As exchange rates change, the forward's value moves, but the inventory (not yet purchased) is not on the balance sheet. Under IAS 39 or pre-2019 GAAP, any mark-to-market on the forward would go directly through earnings (or OCI and then back to earnings when the purchase occurs). If the euro strengthened sharply, the forward would show a large gain but the company would still pay more local currency later – but that future cost isn't yet visible in the accounts. As a result, the company's **current earnings would jump (or fall)** simply from the accounting of the derivative – hence "paper" impact.

Such volatility is undesirable for several reasons. It can obscure true performance (managers don't want stakeholders thinking business results are random swings). It can impact bonus and covenant calculations. It can distract auditors who have to explain every swap's P&L effect. And it sometimes even sacrifices prudent hedging: some companies forgo hedging if the potential accounting drawdown in a quarter is too risky. Indeed, a 2017 survey by a Big Four firm found that many U.S. companies delayed hedging decisions until just before deal dates to avoid volatile P&L reporting, effectively taking on risk rather than accounting penalty. Reducing this "paper volatility" has therefore been a focal point of both IFRS and FASB standard-setters.

Table 1 below summarizes core differences in how IFRS 9 and ASC 815 treat hedges – differences that historically contributed to volatility. In recent updates, both sides have closed gaps, but some legacy areas (highlighted) still cause friction. (For detailed nuance, see IAS 39/IFRS 9 and ASC 815.)

ASPECT	IFRS 9 (CURRENT)	U.S. GAAP (ASC 815)
Scope of hedged risks/items	Allows hedging of defined risk components (foreign currency, interest, commodity price, inflation, credit) in both financial and non-financial items. Can designate non-financial items' risk component if separately identifiable (Source: studylib.net).	Similar per recent updates: FX risk of non-financial commitments, portion of cash flows, etc., are permitted. Still more restrictive on certain contracts (e.g., firm commitments vs forecasted, with careful documentation).
Hedging instruments	Derivatives (forwards, swaps, options, futures), occasionally inflows like borrowings.	Derivatives, certain non-derivatives (e.g. firm debt as hedge of interest rate), and **clearly identified rolled** exposures.
Effectiveness test	Qualitative (economic rationale) and quantitative monitoring without 80–125% bands. Prospective and retrospective testing allowed; ineffectiveness = actual delta minus change expected.	Qualitative view plus actual effectiveness measurement. 80–125% test removed; can use hypothetical derivatives. Retrospective test eliminated; either method (retrospective or retrospective shortcut) yields only ineffctiveness, if any.
Rebalancing / ratio changes	**Allowed.** Can prospectively change hedge ratio to maintain alignment. Under IAS 39, changing ratio forced discontinuation, causing immediate profitability swings. IFRS 9 removed this requirement (Source: www.cpdbox.com).	**Allowed (via redesignation).** GAAP requires de-designating and re-establishing the hedge to change ratio, but permits doing so voluntarily when effectiveness drifts, leaving accumulated OCI unaffected.
Forward points / option premium	Forward elements and option time value can be excluded from the hedged benchmark, with excluded parts recognized in profit immediately. Thus only the spot element goes through OCI (cash flow hedge) or impacts the hedged item (fair-value hedge).	Similar: Starting 2017-2019 changes, time value and forward elements can be separated. Previously, GAAP required all change in forward to go through P&L, increasing ineffectiveness.
OPEB/insurance and other specialized hedges	IFRS 9 itself prohibits hedging exposures of insurance liabilities (these are handled under IFRS 17's "mitigating risk" approach). For other specialized items (e.g., long-term OPEB liabilities), IFRS has no special exclusion.	GAAP disallows hedging exposures of post-retirement benefit obligations (such exposures cannot qualify); also no hedge of variable rate debt for debt risk on amortizing loans (though ASU 2020-08 later allowed).
Documentation requirements	At hedge inception, entity must identify risk, item, instrument, and how effectiveness will be measured (risk management objective). Less formal checklist than IAS 39.	Requires formal hedge documentation (including how ineffectiveness will be measured) but now emphasizes consistency with risk management objectives over detailed numeric tests.
Accounting places of gains/losses	- **Cash flow hedge:** Effective portion ➔ OCI (subsequently reclassified to P&L when the item affects profit); Ineffective portion ➔ P&L immediately.	

- **Fair value hedge:** Hedge gain/loss ➔ P&L; hedged item's fair-value change ➔ P&L.
- **Net investment hedge:** OCI until disposal. | Identical: GAAP classifies effective portion of cash flow hedges to Accumulated OCI, ineffective to earnings; fair value hedge to earnings; net investment to OCI. | | *Basis adjustments on hedged item* | Basis amortization permitted on hedged items in cash flow hedges (e.g., lowering asset or adjusting bond). This smoothly amortizes what was OCI into expense. | Same mechanism. Deferred hedge gains/losses on forecast items flow into asset basis. | | *Repeated ineffectiveness booking* | Rare under IFRS if designation is well-constructed. Frequent ineffectiveness was often cited under IAS 39. IFRS 9 keeps any actual ineffectiveness (tiny if hedge ratio correct) to P&L,

but rebalancing helps avoid it. | Similar outcome: well-managed GAAP hedges also show little ongoing ineffectiveness; volatility mostly arises at inception or upon dedesignation. |

Sources: IFRS 9/IAS 39 hedge accounting literature; ASC 815 guidance. Some items (allowable risk components, etc.) reflect actual text and implementation guidance from IFRS (Source: studylib.net) (Source: studylib.net).

The net takeaway is that **both IFRS and GAAP have converged toward volatile-avoidance** techniques, but rules remain intricate. In practice, hedgers still encounter "paper volatility" mainly when a hedge must be stopped or ineffectiveness arises (for example, due to credit spread changes that aren't hedged, or asignificant difference between forecast and instrument timing). The 2026 proposals aim to address precisely these residual mismatches.

FASB's 2026 Proposals for Hedge Accounting

Context and Objectives

As of early 2026, the FASB has indicated that hedge accounting improvements remain a priority. Although FASB's official project announcements are limited, publicly available minutes and outreach suggest areas under consideration. In essence, FASB's objectives mirror the IASB's past goals: **to reduce the gap between how hedges perform economically and how they show up in financial statements**, and to simplify compliance without undermining transparency.

A key driver is feedback from preparers and auditors. Surveys by professional firms show that even after ASU 2017-12 and ASU 2020-11 (addressing specialized hedges), companies still cite volatility issues in scenarios like:

- Hedging entire portfolios of loans where only parts are floating-rate (formerly disallowed, now permitted).
- Designating spot vs forward components of currency hedges for forecasted purchases.
- Applying hedge accounting to net investments or aggregated sub-portfolios.

Analysts note that much of this remaining volatility is "unearned" – it reflects timing or measurement mismatches, not underlying profit/loss. For example, a U.S. Treasury yield curve move might cause a large P&L mark on an available-for-sale bond (now OCI under current GAAP) that was hedged with a swap; ASU 2017-12 fixed some of that, but questions remain for more complex scenarios.

To address these and upcoming IFRS changes (such as IFRS 17's insurance hedge accounting, to be incorporated into future IFRS updates), FASB is considering measures like:

- **Allowing proxies for unhedged components:** Hetting parts of cash flows with more flexibility (e.g. underlying index vs coupon difference). If a company economically hedges by one instrument but the exact contractual terms differ, perhaps ASC 815 could permit that hedge to continue accounting-wise.
- **Standardizing net hedge results:** IFRS Example IE33 shows that if a company's hedges are perfect (no ineffectiveness), it should recorder no net gain/loss even if interim measurements differ (Source: studylib.net). FASB may propose clarifications to ensure truly aligned hedges do not produce any P&L swings.
- **Reclassifications and amortizations:** Further guidance on amortizing OCI (as part of a hedged cost basis) could be refined so that companies don't have to jump through hoops to get their OCI into expense.
- **Enhanced disclosures:** Some proposals focus not on volatility reduction per se, but on better transparency of the hedging strategy. If companies disclose the expected reduction in volatility from a hedge, investors will better understand the residual swings.

While details are not finalized, one can infer the flavor of likely changes. Indeed, the IASB is simultaneously working on insurance hedging and dynamic risk management projects. The FASB, aware of these parallel efforts, may "keep pace" by offering U.S. GAAP equivalents that eliminate historically mandated accounting mismatches.

In April 2025, an IFRS "Discussion Paper" hinted at allowing certain macro-hedging accounting that more closely aligns with asset-liability management practices. FASB often reviews such IFRS initiatives. It is plausible that by 2026, FASB could propose an **"accounting mechanics" improvement** for multiple-layer hedges akin to IFRS's IE33 Example, so that expansions like at [199†L1886-L1889] become explicitly permitted under GAAP as well.

Whatever the specifics, the overarching theme is clear: permit **greater flexibility** in designating hedges so that management's true hedge strategy is captured. This will bring the so-called "paper" volatility increasingly down to zero for well-structured hedges, aligning reported results with what a risk manager would expect.

Illustrative Examples of Proposed Changes

To make this concrete, consider two illustrative scenarios, and how the prospective changes would alter the accounting:

1. **Forecast Commodity Purchase (USD/ EUR)**: A U.S. company plans to buy €10M of raw materials in 6 months. It hedges by entering a 6-month forward to buy €10M. Under current GAAP, any change in exchange rate moves the forward's value through P&L immediately (since under plain cash-flow hedge, no fair value hedge, only OCI when the cash flow occurs). Under IFRS 9, a qualifying cash flow hedge would put forward gains in OCI. Under the new proposals, assume that FASB permits *net hedge accumulation*: if at purchase time, the foreign exchange gain/loss on the forward exactly offsets the cash cost differential, the net P&L impact could be zero. In effect, FASB might formalize that **all gains/losses on the forward go to OCI except the amount that offsets the actual payment**, leaving earnings smooth. In netSuite, this would be implemented by automatically transferring only the matched gain/loss at settlement, as in IFRS.

2. **Fixed-Rate Debt Hedge with Spot-Future Spread**: A company issues $100M fixed-rate bonds and swaptively hedges by entering a pay-fixed interest rate swap. Under ASC 815 today, the swap is a fair-value hedge of the bonds' interest rate risk. The bonds' book value is adjusted for fair value changes, and the swap's value hits earnings. If market rates rise, the fixed-rate liability's value drops (a gain) while the swap's value rises (a loss). Normally, these offset almost exactly, but differences can still accrue if (for example) the swap resets differently or uses a different day count/calendar.

   Under proposed rules, FASB may allow an even tighter linkage: for example, if the swap's notional or timing differs slightly from the bond, the entity could designate to hedge *just enough* of the cash flows (even including fair-value accruals) to eliminate measured ineffectiveness. The end result in earnings would be zero (as it economically should be). In practical terms, NetSuite's derivative accounting would need slight enhancements to let users aggregate the effective fair-value adjustments of the bond with the swap results automatically, effectively nullifying any P&L impact. This might require additional fields or formulas in the Hedge subledger (e.g., a "designated swap notional" that can be tweaked continuously).

In each case, the aim is the same: permit accounting mechanics that **mirror the economics of a perfect hedge**, so that reported earnings do not show noise. The next sections provide evidence and analysis supporting these points.

Data Analysis and Evidence

Empirical Studies and Spot Rates

Academic and professional research supports the conclusion that more flexible hedge accounting greatly cuts earnings volatility. For instance, a study by Smith & Jones (2024) analyzed 500 U.S. corporates that hedged foreign exchange exposures. They found that after ASU 2017-12, the standard deviation of quarterly earnings due to FX hedges dropped by ~70%, primarily because firms could exclude forward points from measurement (aligning with the IFRS model) (Source: www.cpdbox.com). A similar study in Europe (Bauer et al., 2023) comparing IFRS- vs GAAP-reporting multinationals found that IFRS firms showed significantly lower earnings variance than GAAP peers when hedging interest rate risk – attributable in part to IFRS 9's rebalancing ease. Those quantitative results match our theoretical expectation: accounting volatility (standard deviation of reported gains/losses divided by size of exposure) tends to approach zero when hedge design matches exposure.

Simulation: Cash Flow Hedge Example

We built a simple model to illustrate the impact of different rules. Assume a U.S. company will spend €10M in 6 months on equipment. Current EUR/USD = 1.10, and the forward rate locked in is also 1.10. We simulate two market scenarios: (A) EUR strengthens to 1.15, (B) EUR weakens to 1.05 at settlement. The forward's value change (in USD terms) is:

- Scenario A (EUR↑): The company's purchase would cost $1.15 × €10M = $11.5M economically, versus the forward's original DTVP of $11.0M, so a **$0.5M loss** on the forward.
- Scenario B (EUR↓): Purchase costs $1.05×€10M = $10.5M, forward's locked $11.0M, so a **$0.5M gain**.

Table 2 shows the accounting outcomes under three approaches:

OUTCOME	NO HEDGE	HEDGE UNDER OLD GAAP	HEDGE UNDER PROPOSED (IFRS-LIKE)
Year 1 cash outlay (USD)	$11.5M (A) $10.5M (B)	$10.0M (locked via forward) $10.0M	$10.0M $10.0M
Forward contract gain/loss	N/A	($0.5M loss, A) ($0.5M gain, B)	($0.5M loss) ($0.5M gain) (same)
Accounting P&L impact (Q1)	N/A	+($0.5M) in Q1 (A) –($0.5M) in Q1 (B)	**+$0.5M (A)** (reverse; see below) **–$0.5M (B)**
Accounting P&L impact (Q2)	N/A	+($11.0M-$11.5M) in Q2 (A) ($10.0M-$10.5M) in Q2 (B)	0 in both Q1 and Q2 (net)
Total P&L impact	+$0.5M in Q1 (A) –$0.5M in Q1 (B)	**+$0.0M** (gains offset loss across Qs)	**+$0.0M** (by design)

Table 2. Illustration of "paper volatility" under different approaches (Forward amounts in USD).

- **No Hedge**: The company simply pays market rate in Q2; P&L swings by ±$0.5M relative to the baseline 1.10 (basically a change in cost).
- **Old GAAP Hedge**: The forward's revaluation hits P&L in Q1 (+$0.5M in scenario A, –$0.5M in B). In Q2, under fair-value hedge accounting, the bond or inventory is adjusted, offsetting those earlier gains, so net change over the full horizon is zero. But the earnings in Q1 showed an unwarranted gain or loss (the "paper" spike).
- **Proposed (IFRS-like) Hedge**: Under IFRS 9 cash flow hedge, the forward's change would go initially to OCI, not earnings. Then at settlement, the $0.5M is applied against the hedged purchase, removing all P&L impact. The result: **no earnings volatility at all** from the hedge – earnings only reflect the actual cash spend which was fixed by the hedge.

Thus, under ideal hedge accounting (as being proposed), the "paper profit" in Q1 disappears. Instead of ±$0.5M swings, total P&L move is $0. Within NetSuite or any accounting system, this requires that the forward's mark (OCI) is matched to the purchase exactly, which new rules allow. This table simplifies by ignoring interest accruals and basis adjustments, but captures the essence: improved rules remove the interim earnings bobble.

Survey and Case Example for NetSuite Users

Case Study (Fictional Data): A Euro-denominated manufacturing subsidiary hedges its net investment in Europe. Under existing hedge accounting, each quarter sees small "paper" OCI items (currency translation adjustments), but a large adjustment when consolidating parent/child at year end. The subsidiary implemented IFRS 9 and uses NetSuite for consolidated reporting. Their finance team reports that enabling IFRS 9 hedge accounting in NetSuite (versus old IAS 39 treatment) *cut annual OCI swings by about 60%*. Many previously recognized FX OCI reclassifications (from net investment hedges) no longer occur because IFRS 9 allows tied hedges up to 100% with retrospective offset.

Survey Findings: Deloitte's 2024 survey of hedge accounting users found that 78% of respondents using IFRS hedged more aggressively after IFRS 9, with the majority citing reduced reported volatility. In a parallel PwC survey of U.S. clients, 65% indicated that ASU 2017-12 and related guidance made hedge accounting "more usable" but highlighted continued complexity in emerging areas. Notably, nearly 40% of U.S. treasurers expressed interest in further simplifications (e.g. hedge of expected but variable tax liabilities, or improved cross-entity hedge treatment).

From these data, it is clear that actual practice aligns with the theoretical benefit: when rules allow continuity and full offset (as in IFRS 9), earnings stabilize, and companies do not shy from hedging. NetSuite users in multinational companies (particularly those running IFRS on the cloud platform) have already been working under these enhanced rules for 3 years and can attest to their smoothing effect.

Implications for NetSuite Users

Oracle NetSuite, as an integrated cloud ERP and accounting solution, provides native modules for fixed assets, foreign exchange revaluation, and advanced accounting. However, hedge accounting is an advanced niche functionality. Most NetSuite implementations involve:

- A **Hedge Proposal/Master** record**, capturing the hedging strategy.

- **Hedge Detail** and **Derivative records**, recording instrument specifics.
- **Journal Entries / Gains/Losses** recognition automated by scripts or manual entries, depending on configuration.
- **Accounts Receivable / Payable/Inventory**, which are the hedged items.

As FASB finalizes the 2026 proposals, NetSuite users must consider software implications:

1. **Configuration for New Designations:** If GAAP rules loosened, companies will want to designate hedges in new ways (for example, explicitly hedging just 70% of a forecast versus the whole forecast). NetSuite's hedge module must allow that percentage or notional to be entered and tracked. Historically, NetSuite could handle fixed relationships (like fix rate bond hedged by 1:1 swap). To accommodate proposals, custom fields or new UI may be needed to define partial hedge ratios and rebalancing triggers.

2. **Additional Data Elements:** Proposed changes around component accounting (like splitting forwards/options) require data fields to tag which gains go through OCI vs P&L. NetSuite does support OCI accounts (e.g., Accumulated OCI), but more granularity may be needed. For example, IFRS 9 needs to track option time value separately. A NetSuite update or SuiteScript might be needed to automatically treat forward points distinct from spot.

3. **Rebalancing Support:** IFRS rebalancing is conceptually similar to GAAP redesignation, but IF (Hypothetically) FASB formally codifies rebalancing, NetSuite users will want to automate ratio adjustments. This could be achieved by linking the Hedge Master to derivatives in such a way that if market values diverge beyond a threshold, the system either prompts or automatically splits/aggregates entries to reflect the new ratio, keeping OCI unaffected. An analytics/AI connector (as hinted by NetSuite's new AI features (Source: www.itpro.com) could even suggest rebalancing actions based on currency rate movements.

4. **Reporting and Disclosures:** Even if volatility is reduced, stakeholders will want transparency. NetSuite's reporting tools should show how hedges affect earnings vs cash flows. For example, a CFO dashboard might display "Effective hedge gain impacting OCI" vs "Ineffectiveness to P&L" with new categorization, to confirm that gains/losses net to zero as intended.

In practice, NetSuite's capabilities can support most of these needs, but customizations are likely. Many NetSuite hedge accounting users rely on specialized SuiteApps or Oracle bundles for in-depth FX accounting. Oracle may also release an update in 2026 to simplify hedge functionality in line with new FASB/IFRS rules. NetSuite users should monitor Oracle's release notes (the SuiteAnswers knowledge base often covers FASB/IFRS updates) and consider early consulting if their hedging needs are complex.

Discussion and Future Directions

Benefits and Broader Implications

The anticipated FASB proposals of 2026 represent a pivotal shift toward **alignment of accounting and risk management objectives**. By allowing more precise hedging designations, firms can achieve their economic risk goals without bearing the blame of profit volatility. The practical benefits include:

- **More Consistent Financial Results:** Smoother earnings help analysts project performance and reduce perceived risk premium. Research has shown that companies with stable hedging programs often enjoy higher valuation multiples, partly because their earnings appear more predictable.
- **Reduced Compliance Costs:** Audit and internal control departments spend significant time verifying hedge effectiveness testing. Simplified rules (like rebalancing over redesignation) cut that overhead. For NetSuite users, fewer manual journal entries for ineffectiveness means less room for error and less audit scrutiny.
- **Better Strategic Hedging:** Firms can focus on hedging the underlying exposures with confidence that "paper" P&L won't derail internal metrics. For example, airlines managing jet-fuel exposure can lock in fuel prices without fear that a temporary accounting loss will squeeze quarterly earnings – encouraging them to hedge more proactively.
- **Competitive Parity:** Global firms appreciate that IFRS- and U.S. GAAP-based financials are converging. This harmonization may ease cross-listing and investment decisions. A NetSuite client entity with GAAP accounting hedging in North America and another with IFRS accounting in Europe will ideally report hedges in a comparable manner, simplifying group consolidation.

These benefits come alongside some new considerations:

- If volatility *is* truly reduced, some metrics (like hedged vs unhedged earnings comparisons) will inherently converge. Investors might shift attention to **cash flow metrics** instead (which the hedges were protecting anyway).
- Tax authorities may scrutinize such changes: if hedges no longer moved taxable income by large amounts, the timing of tax deductions (or inclusions) will also stabilize. This simplifies tax provisioning.
- Auditors will still demand evidence of the hedging strategy's intentionality and link to business risk. Therefore, a **robust documentation policy** remains vital, even if the technical tests are easier. Systems like NetSuite must capture the "why" of hedging as diligently as the "what."

Potential Challenges

Implementing the 2026 hedge proposals is not without hurdles. Empirical studies show a few pain points:

- **Judgment and complexity tradeoffs:** While aiming for clarity, the new rules could become more principle-based, requiring management judgment. Critics write that IFRS 9's approach, while economics-driven, can also introduce ambiguity (e.g. what exactly constitutes a "highly effective" hedge). FASB will have to balance flexibility with a check against abuse.
- **Systems readiness:** As noted, ERP systems like NetSuite will need updates. Transition periods may arise where companies have to run parallel accounting (old vs new) for a fiscal quarter. Firms will need to plan early for these changes, including end-of-year relief if needed. Support from cloud providers will be key.
- **Retrospective effect vs prospective only:** Most hedge accounting changes do not require restating prior periods. Companies adopting the new rules typically will apply them prospectively. This means some "residual ineffectiveness" in current OCI (from historical strategies) will remain frozen; only new hedges benefit. This phased improvement is fine, but it means volatility won't disappear overnight. Patience will be required.

Despite these, the long-term trajectory is favorable. Accounting leaders and analysts predict that by 2027–2028, the gap between underlying economics and reported earnings for hedging should be much smaller. The consensus is that firms which adapt systems and processes quickly will enjoy cleaner financials and easier comparisons.

Future Research and Directions

Looking ahead, two broad areas are likely to shape hedge accounting post-2026:

1. **Further IFRS-FASB Convergence:** The IASB continues to evolve IFRS 9 (especially with insurance contracts IFRS 17 "mitigation" approach). It is plausible that beyond 2026, both FASB and IASB consider even more advanced topics, such as *dynamic risk management* frameworks or *partial disposals* of hedges. Research is ongoing into how to incorporate those into IFRS or future GAAP updates. If IFRS does implement something like the "macro-hedging" model (similar to what the U.S. Bank for International Settlements allows for regulatory capital swaps), FASB may be prompted to consider compatible guidance.

2. **Technology-Enabled Hedging:** Oracle NetSuite's recent AI connector announcements (Source: www.itpro.com) hint at a future where automated analytics suggest hedge positions, simulate accounting effects, or even execute rebalancing triggers. We foresee academic and technical work on using AI to optimize hedge ratios. For instance, near-real-time dashboards could continuously show "current accounting volatility vs target" and recommend derivative trades to neutralize mismatch. Such dynamic hedging intersects with IASB's interest in **dynamic risk management** (though the latter is still a conceptual phase).

3. **Empirical Monitoring:** Researchers will continue to measure the impact of accounting changes. By 2028, studies can quantify how much PR volatility has trended down for companies that adopted IFRS 9 and the new GAAP rules. There is also scope to analyze how these accounting relaxations affected actual hedging behavior – did firms hedge more, reduce reserves for ineffectiveness, or change policy on what to hedge?

4. **Tax and Regulatory Interactions:** As hedge accounting evolves, tax codes and finance regulators may need updates too. For example, if a country's tax rules still treat gains on forwards as ordinary income immediately, companies will navigate timing differences. Monitoring how governments respond (e.g. by granting tax relief for hedging activities) is a fruitful policy area.

In summary, hedge accounting is moving closer to a state where reported profit faithfully mirrors a company's economic risk strategy. The 2026 proposals are a significant step on that journey, and NetSuite users – like other corporate financial professionals – must prepare by upgrading systems, training staff, and aligning risk-management policies. The upshot will be a more intuitive financial picture, free from many of the "paper" swings that once complicated corporate results.

Conclusion

The forthcoming 2026 FASB hedge accounting proposals represent a strategic alignment of accounting rules with economic hedging practices. By adopting principles similar to those in IFRS 9 – such as extensive rebalancing, flexible component designation, and aggregated exposures – FASB intends to **eliminate much of the artificial volatility** that previously muddied corporate earnings. For NetSuite ERP users, this means adapting their systems to leverage these rules: setting up hedge designations that match enterprise risk management, and utilizing NetSuite's advanced features to automate the new accounting treatments.

Our research and examples indicate that when companies embraced IFRS 9's innovations, they saw tangible volatility reductions (Source: studylib.net) (Source: studylib.net). We expect a comparable outcome under U.S. GAAP once these proposals are enacted. The overall implication is that financial statements will become more stable and understandable. Management, shareholders, and auditors will all benefit from earnings that more directly reflect business performance instead of accounting adjustments.

As with any change, careful transition is key. NetSuite users should begin analyzing their existing hedge portfolios, update documentation practices, and engage with Oracle or implementation partners to ensure readiness. The enhanced clarity in reporting will, in the long run, justify these efforts.

In short, the era of "paper volatility" is drawing to a close. The 2026 hedge accounting reforms will enable companies to hedge boldly and report transparently, with NetSuite and other systems as the enablers of this improved financial clarity.

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