

March 9, 2007

Ms. Suzanne Q. Bielstein  
Director – Major Projects and Technical Activities  
FINANCIAL ACCOUNTING STANDARDS BOARD  
401 Merritt 7  
Norwalk, Connecticut 06851

Dear Ms. Bielstein:

The Financial Reporting Committee (“the Committee” or “the FRC”) of the Institute of Management Accountants appreciates the opportunity to provide its views to the Financial Accounting Standards Board (“the FASB”) exposure draft of December 8, 2006, entitled *Disclosures about Derivative Instruments and Hedging Activities: An Amendment of FASB Statement No. 133* (“the Exposure Draft” or “the ED”). FRC is the financial reporting technical committee of the Institute of Management Accountants. The Committee reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations.

Overall, we support and agree with the objective of the ED to enhance the transparency of derivative instruments and hedging activities in financial reporting. However, we do not believe that the ED achieves its objective of enhancing transparency. Instead, we believe as drafted the ED will add significantly to the complexity of financial reporting by adding new disclosure requirements that are burdensome to prepare and do little to enhance the understandability of an entity’s use of derivative instruments and hedging activities. In this regard, we have four major concerns:

1. **Need for More Principles-Based Disclosures.** Major aspects of the Exposure Draft seem to contradict the FASB’s expressed goal of principles-based standards. While many parts of the Exposure Draft are consistent with principles-based standards, we believe certain provisions are overly prescriptive. For example, we understand that a tabular presentation may be an effective reporting method but do not agree that tabular presentation should be specifically required. Further, it is unclear that the delineation between derivatives in asset and liability positions

provides significant relevance to financial statement users. We are concerned that these significant changes in financial reporting might suggest more of an ad hoc approach than the presence of an overarching plan to the issue of disclosures.

2. **Excessive Interim Disclosures.** We believe that all major changes in disclosure should be subjected to a thorough inquiry into the benefits of the proposed changes. In our view, the ED's requirement to present the required information in all interim periods imposes an unnecessary burden on financial-reporting processes. Existing rules (both SEC and APB 28) already require interim disclosures if there has been either a material change in risk-management strategy or risk profile, or a material change from information included in the annual footnotes. We believe this existing framework is adequate for interim reporting. Along the same lines, we believe the combination of FAS 157, FAS 159, and this proposed change in FAS 133 imposes daunting requirements on issuers at a time when companies are subject to accelerated filing requirements. Rather than continuing to require incremental interim disclosures in each new standard, we believe that the Board would be well-served to develop principles for delineating disclosures required only for annual periods and those mandated for interim periods.
3. **Disclosure of Contingent Features.** We believe it is important that the FASB further specify the type of contingent features requiring disclosure in order to avoid the unintended consequence of requiring information on more than was intended, resulting in undue burden for the preparer and meaningless disclosure for the investor.
4. **Disclosure of Derivative Notional Amounts is not Efficient.** We also believe that the disclosure of notional amounts and leverage is an ineffective method by which to communicate the magnitude and economic volatility of risks to be managed. These measures are inconsistent with FASB's stated objective of greater transparency and enhancing users' understanding.
5. **Gross versus Net Presentation of Derivative Positions.** We question the benefit of requiring gross presentation of derivative positions as net presentation is widely allowed under GAAP; for instance, FAS 157 disclosures are net, FIN 39 permits net based on specific criteria.

Within Appendix A we have addressed the specific questions for which the Board is requesting feedback. We will be pleased to meet with the Board and Staff at its earliest convenience to discuss these issues in more depth and to clarify any comments contained herein.

Sincerely,



Pascal Desroches  
Chair, Financial Reporting Committee  
Institute of Management Accountants

## Appendix A

### Scope

**Issue 1:** *Do you agree with the Board's decision to exclude from the scope of this proposed Statement prescriptive guidance about how derivative instruments should be presented and classified in the financial statements? Why or why not?*

We agree that prescriptive guidance to specify financial-statement presentation and classification is inconsistent with a principles-based standards-setting objective and unnecessarily restricts meaningful financial reporting. Any attempt to specify the presentation and/or classification of financial reporting should be addressed with a more-holistic assessment of the financial-reporting model and evaluation of whether there should be a disclosure framework.

However, we affirm and appreciate that the ED provides some flexibility to accommodate different reporting for entities using different types of derivatives. However, as we noted in our cover letter, we believe that major aspects of the proposal are prescriptive. Our specific recommendations relative to what we consider to be the overly prescriptive nature of this proposal are included in our comments about the remaining issues.

**Issue 2:** *As drafted and like SFAS 133, the proposed Statement applies to both public and private entities. Do you agree that it should? Why or why not?*

We agree. The impetus of this project is to increase transparency of derivative transactions to financial statements. We believe the basic information needs of publicly- and privately-held companies are similar. Thus, we see no compelling reason why the proposed disclosure enhancements should be limited to public entities.

### Costs of Implementing the Proposed Statement's Disclosure Requirements

**Issue 3:** *This proposed Statement would require an entity to provide information on derivative instruments (including, but not limited to, notional amounts and fair value amounts), hedged items, and related gains and losses, by primary underlying risk, accounting designation, and purpose in the tabular format shown on p. 14 of the ED. Do you foresee any significant operational concerns or constraints in compiling the information in the format required by this proposed Statement? Are there any alternative formats of presentation that would provide the data more concisely?*

Requiring disclosures “in the tabular format shown” seems unduly prescriptive and contrary to a principles-based approach. Again, we reiterate our strong preference for principles, not prescriptions.

Some of our members who are dealers in derivative instruments will need to incur significant upfront investments to re-engineer transaction-level systems on derivatives to comply with the specific disclosure requirements under the Exposure Draft. In addition, we believe the proposal’s requirements to present the required information in all interim periods imposes an unnecessary burden on financial-reporting processes. It also further increases complexity as a result of accelerated interim filing requirements. We do not believe the benefits of providing this information in interim periods are either justified or evident.

Existing rules (e.g., SEC; APB 28) on interim reporting already require disclosures if there has been a material change in risk management strategy or risk profile or if there has been a material change versus information included in the annual footnotes. We believe this existing framework to interim reporting is adequate.

From a broader perspective, recent accounting standards and exposure drafts have significantly increased the requirements to provide detailed disclosures for each reporting period without a broader assessment of the costs and benefits. Rather than continuing to require incremental interim disclosures in each new standard, we believe that the Board would be well-served to develop principles to differentiate between disclosures required for annual periods only and those required for interim periods. Such principles should be available for public comment prior to implementation.

Were the Board to eliminate the interim disclosure requirements, to avoid mandating a specific format, and to reduce the level of required tabular disclosures related to underlying items being hedged, we believe the operational aspects to adopting and complying with this proposal would be manageable. Specifically, gross classification of instruments by derivative assets and liabilities and tracking positions which are closed during the period will require the costly systems enhancements as discussed earlier. FRC representatives have commented that managers in the financial industry do not manage risks within their portfolios based on whether derivatives are assets or liabilities. We question the benefit of such information to users when the preparers do not currently use such information in either assessing hedge effectiveness for accounting purposes or risk management for economic purposes. We also believe that, as written, the proposal will significantly increase the volume of the disclosures.

**Issue 4:** *This proposed Statement would require disclosure of (a) the existence and nature of contingent features in derivative instruments (for example, payment acceleration clauses), (b) the aggregate fair value amount of derivative instruments that contain those features, and (c) the aggregate fair value amount of assets that would be required to be posted as collateral or transferred in accordance with the provisions associated with the triggering of the contingent features. Do you foresee any significant operational concerns or constraints in compiling that information for this disclosure?*

The term *contingent feature* conveys a meaning far broader than we believe the FASB intended. It appears that the FASB's intent in adding this requirement was to help financial-statement users to better understand the likely liquidity consequences of a credit downgrade. If that is the FASB's intention, then we respectfully request that it be plainly stated as such. On the other hand, if the FASB did not intend that, then we hope it will clarify the meaning of this paragraph because the term *contingent feature* is unduly ambiguous. However, we would be concerned if the Board were to take a very broad view of the term *contingent feature* as for an entity with numerous derivatives, the information could be voluminous, collection could require significant system changes, and usefulness of the information is questionable.

Further, we infer that, as written, Footnote 12a4 (p. 5 of the Exposure Draft) asserts that certain contingent features are not really contingent features for purposes of the proposed requirement. Such ambiguity complicates the task of determining exactly what the FASB's intent is.

### **Disclosure of Notional Amounts**

**Issue 5:** *This proposed Statement would require disclosure of notional amounts in tables that also will include fair values of derivative instruments by primary underlying risk, accounting designation, and purpose. Do you agree that this proposed Statement should require the disclosure of notional amounts? Why or why not?*

We disagree. Paragraph B24 asserts that requiring disclosure of derivative notional amounts (including related leverage) would "provide insight into the overall volume of derivative use and into the magnitude of risks being managed." We respectfully disagree. We believe that the disclosure of notional amounts (including the effect of leverage thereon) of derivative instruments designated in qualifying hedging relationships does not give financial-statement users information conducive to a more-transparent understanding of an entity's risk management strategy. The Board addressed the issue of whether to disclose notional amounts in its deliberations for FAS 133. We cannot identify compelling factors to override the Board's rationale not to require notional-amount

disclosures as provided in paragraph 512 of FAS 133. We also believe that such disclosure does not enhance users' understanding of the impact of derivatives on an entity's financial position, results of operations, or cash flows. For example, assume that an entity wanted to hedge its exposure to \$5 million of interest-rate risk with a strategy that uses ten 91-day forwards, each with a notional amount of \$5 million over 30 months. We fail to see how disclosing the fact that notional amounts totaling \$50 million are being used to hedge \$5 million of risk accurately reflects the manner in which the entity manages its exposure. Therefore, we do not see how requiring disclosure of these notional amounts helps users.

Rather than mandating disclosure of notional amounts as indicated by the rationale in Paragraphs B21-B25, we recommend that the FASB remain consistent with its stated objective of enhancing the understanding of uses and accounting for derivatives as of a reporting date rather than attempting to provide disclosure of how entities manage the risks to which they are exposed. We believe that the desirable policy should allow users of derivatives to assess the effect of derivative instruments on their entity's financial position, results of operations, and cash flow in a manner similar to that which is required by IFRS No. 7 and SEC Financial Reporting Release No. 48 (e.g., through risk-sensitivity analysis or VAR [value-at-risk] analysis).

**Issue 6:** *This proposed Statement would require disclosure of gains and losses on all derivative instruments that existed during the reporting period regardless of whether those derivatives exist at the end of the reporting period. This proposed Statement would not require disclosure of the aggregate notional amounts related to those derivatives that existed during the reporting period but no longer exist at the end of the reporting period. Do you agree that this proposed Statement should not require the disclosure of the aggregate notional amounts related to derivatives that no longer exist at the end of the reporting period? Why or why not?*

We agree that it is unnecessary to disclose notional amounts related to derivatives that no longer exist at the end of the reporting period. However, current information systems do not distinguish between derivatives that are active and those that no longer exist at the end of the reporting period. The cost to isolate the income statement impact of such derivatives that do not exist far exceed any benefit such information can provide. That is especially true for derivatives that are treated as trading with changes in fair value being recorded in the income statement. Furthermore, we question whether such a reporting requirement can be implemented with current transaction systems.

### **Disclosure of Gains and Losses on Hedged Items**

**Issue 7:** *This proposed Statement would require disclosure of the gains and losses on hedged items that are in a designated and qualifying hedging relationship under Statement 133. The Board decided that an entity would not be permitted to include information in the tables on “hedged items” that are not in designated and qualifying Statement 133 hedging relationships because “economic hedging” means different things to different people. Do you agree that information about “hedged items” that are not in designated and qualifying Statement 133 hedging relationships should be excluded from the disclosure tables? Alternatively, should the tables include gains and losses on “hedged items” that are recorded at fair value and are used in hedging relationships not designated and qualifying under Statement 133? Why or why not? Would your answer be affected by the forthcoming FASB Statement on the fair value option for financial assets and financial liabilities, which will provide the option to report certain financial assets and liabilities at fair value?*

We agree with the Board’s conclusion not to require information about such “hedge items.” However, an entity should be permitted to provide additional disclosure regarding such “hedged items” if the entity believes that such disclosure improves the overall discussion of its risk management strategy.

### **Disclosure of Overall Risk Profile**

**Issue 8:** *Under this proposed Statement, quantitative information about non-derivative instruments used as part of an entity’s overall risk management strategy would not be included in the disclosure tables. However, paragraphs 44 and 45 of Statement 133 would permit an entity to provide qualitative and quantitative information about the derivatives included in the disclosure tables as those derivatives (a) relate to the overall context of its risk management activities and (b) are related by activity to other financial instruments. Do you agree that information that could be provided in the qualitative and quantitative disclosures encouraged by paragraphs 44 and 45 of Statement 133 would be sufficient to appropriately inform users of financial statements about the risk management strategies of an entity? If not, should additional information about an entity’s overall risk management strategies be provided as part of the tabular disclosure required by this proposed Statement?*

Public entities are currently required to provide quantitative and qualitative disclosures about risk in their periodic filings. Therefore, we do not believe incremental guidance is warranted.

