ThyssenKrupp

Letter of Comment No: 6
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ThyssenKrupp AG · P.O. Box 10 10 10 · 40001 Düsseldorf, Germany

Order Department
Financial Accounting Standards Board
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Re: File Reference 1100-163: Original copy of comment letter pursuant to e-mail sent on June 20, 2002 regarding Statement 133 on derivative instruments and

Düsseldorf, June 21, 2002

hedging activities.

Dear Madam or Sir,

The Company

ThyssenKrupp is a multi-billion dollar corporation with worldwide operations in numerous different industries and has been applying US GAAP in addition to local accounting standards for approximately three years. The Corporation is comprised of seven segments, the largest of which is Steel. ThyssenKrupp Steel is the world's largest flat stainless steel producer and among the largest flat carbon steel producers. Two other large segments, Automotive and Elevator, have significant operations throughout the United States and Europe. Automotive produces automobile body, chassis, and powertrain components. Elevator is the largest supplier of elevators and elevator equipment in the United States and is the third largest in the world market. The remaining segments consist of Technologies, Materials, Serv and Real Estate.

Main Issue

Given the wide array of industries and markets in which ThyssenKrupp operates, we have experienced certain business transactions where separate accounting for embedded foreign currency derivatives is not logical but is necessary according to paragraph 15 of FAS 133. Therefore, we feel that FAS 133 is not fully inclusive and should provide a few additional exceptions which allow the embedded foreign currency derivative instrument to **not** be separated from the host contract. The additional exceptions that we propose are explained in the comments and examples below.

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Comment One – Plant Construction Contracts

ThyssenKrupp has several subsidiaries operating in the engineering sector with large scale turn key contracts in foreign countries. Services provided under these turn key contracts (hereafter, primary contracts) are engineering work, procurement of main supply materials and services, supervision of erection and commissioning of plants and the overall responsibility of the plant meeting the contract requirements. Given the size of many of these primary contracts, ThyssenKrupp outsources some of the work to third parties under subcontracts. These contracts can extend over eight or more years and cost in excess of €500 million. The subcontracts are separate contracts which are legally distinct from the primary contract but are specifically entered into for purposes of receiving goods or services necessary for fulfillment of the primary contract.

It is quite common that the third party contractor is located in a country other than that of our subsidiary or the other party involved in the primary contract. Therefore, the functional currency of the third party contractor may be different than the functional currency of our subsidiary. In order to avoid currency risk, our subsidiary requires that the subcontract be denominated in the same currency as the primary contract (even if the currency is different than the functional currency of both our subsidiary and the third party contractor).

Under the current rules, the embedded foreign currency derivative instrument related to the subcontract must be accounted for separately. This results in our subsidiary being exposed to income fluctuations, when in fact no income volatility occurs because future US Dollar cash outflows are completely offset with future US Dollar cash inflows. Therefore, the question arises whether the „normal" functional currency definition of FAS 133 is sufficient to cover the accounting for a non-US-company. For instance, if our subsidiary would be allowed to determine the „functional currency" of the primary contract and could provide evidence that the subcontracts are in a tight relation to the primary contract, there is no reason for bifurcating an embedded derivative. We feel that in these circumstances bifurcation is not necessary and only creates additional work.

We have provided five example transactions below which illustrate the different scenarios that typically occur.

Example 1

A primary contract denominated in US Dollars (USD) is entered into with a foreign customer (US company). The functional currency of the foreign customer is USD. A subcontract, which is also denominated in USD, is entered into with a third party. USD is also the functional currency of the third party.

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Accounting result: Primary contract - As the currency of the primary contract is the same as the functional currency of the customer, separate accounting for an embedded derivative is not necessary. Subcontract - Since the currency of the subcontract is the same as the functional currency of the third party contractor, separate accounting for the embedded derivative is not required. Therefore, there is no impact on the income statement due to embedded derivatives.

Example 2

A primary contract denominated in USD is entered into with a foreign customer (Venezuela). The functional currency of the foreign customer is Venezuelan Bolivar. Subcontracts, which are denominated in either Euro or USD, are entered into with third party contractors. The functional currencies of the third party contractors are either Euro or USD.

Accounting result: Primary contract - As USD is not the functional currency of either party of the primary contract a bifurcation of the derivative (forward exchange contract / purchase of USD) from the host contract is required under FAS 133 because the exception of FAS 133 paragraph 15 (a) can not be used. Subcontracts - Since the currencies of the subcontracts are the same as one of the functional currencies of the parties involved, separate accounting for the embedded derivatives is not required because they qualify as exceptions.

Example 3

A primary contract denominated in USD is entered into with a foreign customer (US company). The functional currency of the foreign customer is USD. A subcontract, which is denominated in USD, is entered into with a third party contractor. The functional currency of the third party contractor is not USD.

Accounting result: Primary contract - As the currency of the primary contract is the same as the functional currency of the customer, separate accounting for an embedded derivative is not necessary. Subcontract – Viewing this contract as being separate from the primary contract, since the currency of the subcontract is not the same as one of the functional currencies of the parties involved, separate accounting for the embedded derivative is required because it does not qualify as an exception.

In this case we feel that separate accounting for the embedded derivative related to the subcontract is not necessary because the currency of the subcontract was intentionally set so that any currency risk is passed on to the third party contractor. Requiring the subsidiary to recognize an embedded derivative and account for fair value fluctuations creates more work without changing any results.

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Example 4

A primary contract denominated in USD is entered into with a foreign customer (Venezuela). The functional currency of the foreign customer is Venezuelan Bolivar. A subcontract, which is denominated in USD, is entered into with a third party contractor. The functional currency of the third party contractor is not USD.

Accounting result: Primary contract - As USD is not the functional currency of either party of the primary contract a bifurcation of the derivative (forward exchange contract / purchase of USD) from the host contract is required under FAS 133 because the exception of FAS 133 paragraph 15 (a) can not be used. Subcontracts – Viewing this contract as being separate from the primary contract, since the currency of the subcontract is not the same as one of the functional currencies of the parties involved, separate accounting for the embedded derivative is required because it does not qualify as an exception.

Similar to the previous example, in this case we feel that separate accounting for the embedded derivative related to the subcontract is not necessary because the only reason for denomination of the subcontract currency in a currency which is not the functional currency of the subsidiary, nor of the contractor, is the currency of the primary contract.

Example 5

A primary contract denominated in three different currencies (Euro – functional currency of the seller; Bolivar – functional currency of the customer; and USD – not a functional currency of either party) is entered into with a foreign customer (Venezuela). The functional currency of the foreign customer is Venezuelan Bolivar. The reason for having USD as one of the currencies is that a portion of the supplies to be used for the contract (heavy equipment) can only be purchased from a subcontractor whose functional currency is USD. Subcontracts, which are denominated in either Euro or USD, are entered into with third party contractors. The functional currencies of the third party contractors are either USD, Euro or Bolivar.

Accounting result: Primary contract – Since two of the currencies of the primary contract are functional currencies of the parties involved, bifurcation is not necessary. However, as USD is not the functional currency of either party of the primary contract a bifurcation of the derivative (forward exchange contract / purchase of USD) from the host contract is required under FAS 133 because the exception of FAS 133 paragraph 15 (a) can not be used. Subcontracts - Since the currencies of the subcontracts are the same as one of the functional currencies of the parties involved, separate accounting for the embedded derivatives is not required because they qualify as exceptions.

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This example is similar to the two previous examples where bifurcating the embedded derivative would lead to an income volatility that does not present the true and fair presentation of the business of that subsidiary, which, in fact, experiences no currency risk on future cash flows.

Summary of Comment One

Certain business transactions are entered into with the intention of better facilitating all of the parties involved and to avoid any unnecessary complexities. Entering into a subcontract with a third party contractor where the subcontract is denominated in the same currency as the closely related primary contract is a means of passing currency risk to the contractor and reducing the need to enter into hedge transactions. Given the nature of the contracts it does not make sense to require that currency fluctuations be recognized in income when, in fact, there is truly no income volatility.

Comment Two – Purchase Contracts for Raw Materials

Several of our subsidiaries, with a functional currency of Euro, operate in the steel production business. For steel production, those subsidiaries must procure iron ore, coal and coaking coal on a large scale.

Procurement of iron ore

All purchase contracts of our subsidiaries for the purchase of iron ore are denominated in USD. Suppliers of iron ore are located in Brazil, Canada and Australia. The functional currency of the supplier is the local currency and not USD.

As the USD is not the functional currency of either party to the contract and there is no official source stating that trades in iron ore are routinely denominated in USD, a bifurcation of the foreign currency exchange contract from the host contract is required as the conditions of FAS 133 par. 15 (a and b) are not met.

We have evidence that 90-95% of the world trade in iron ore is contracted in USD. For this reason we are of the opinion that USD is the currency in which contracts to procure iron ore are routinely denominated. For this reason we tend to not bifurcate any embedded derivative in an iron ore contract.

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Procurement of coal and coaking coal

Nearly 100% of the purchase contracts for coal and coaking coal in our subsidiaries are denominated in USD. The suppliers for coal and coaking coal are located in Germany, the USA, Canada, Australia and the Netherlands. Those contracts that are not denominated in USD are indirectly linked to the USD via a price redetermination clause.

We have evidence that 90-95% of the world trade in coal and coaking coal is contracted in USD. For this reason we are of the opinion that USD is the currency in which contracts to procure coal and coaking coal are routinely denominated. For this reason we tend to not bifurcate any embedded derivative in a coal or coaking coal contract.

Where do we get approval for our treatment of procurement contracts for iron ore, coal and coaking coal? The example in SFAS 133 par. 15 (b) states crude oil as the only exception. Is there a list of goods that fall under this exception?

Comment 3 – Pass-through Trading (Simultaneous Purchase and Sale)
Some of our subsidiaries that belong to the materials segment are involved in the trading of varying qualities of steel. Functional currency of those subsidiaries is the Euro. Their customers are located in countries throughout the world. These subsidiaries purchase goods in USD and the sale of those goods often takes place at the same point in time. As the sales contract is denominated in USD as well, our subsidiaries are not exposed to foreign currency risk. Thus, they do not hedge these transactions via derivatives. However, in most cases there exists a timing difference between the conclusion of the purchase and sales contracts on the one side and the realization (delivery) on the other side. Under previous accounting rules the pending transactions were not accounted for, whereas after realization both trade accounts receivable and payable were accounted for at spot rates.

After SFAS 133 and especially the embedded derivatives section of it have been issued, income volatility has entered the books of our subsidiaries.

Case 1
If customer and supplier do not use the USD as their functional currency, there is no income volatility because

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embedded derivatives are accounted for on both sides.

Case 2

If only one party, the customer or the supplier, has USD as its functional currency, then only one contract comprises of an embedded derivative that needs to be bifurcated according to the rules.

Economically there exists no income volatility due to exchange rate changes (margin disregarded) from those transactions. Therefore, we are of the opinion that SFAS 133 does not represent a true and fair presentation of the economic situation of those subsidiaries. If a purchase contract and a sales contract are linked in a way that can be proved by the subsidiary, those contracts should be viewed as one unit. In those cases embedded derivatives should not lead to income volatility, because this leads to a clear misrepresentation in the income statement.

We appreciate the opportunity to comment on this proposal and we hope that the FASB will consider our views and respond accordingly. We would be glad to discuss any of our comments with you in more detail.

Sincerely,

ThyssenKrupp AG

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