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LETTER OF COMMENT NO. 91

August 15, 2008

Mr. Russell G. Golden, Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

File Reference #: 1590-100

Proposed Statement of Financial Accounting Standards – Accounting for Hedging Activities an amendment of FASB statement No. 133

Dear Mr. Golden:

Johnson & Johnson would like to comment on the proposed statement of financial accounting standards related to the above-mentioned topic. We feel that it is important for the FASB to understand the underlying philosophy that drives the use of derivatives for Johnson & Johnson. We engage in the use of derivatives as a prudent risk management tool, focused on mitigating the cash flow risks that underlie the business activities of Johnson & Johnson. The alignment of the gains and losses of the derivative and the underlying exposure provides greater transparency to the use of derivatives as a risk-mitigating tool and reduces volatility to the shareholders.

To that end, we understand and support the FASB Staff efforts in addressing this topic to simplify accounting for hedging activities, improve the financial reporting of hedge activities, resolve major practice issues related to hedge accounting, and address differences resulting from recognition and measurement anomalies between the accounting for derivative instruments and the accounting for hedged items or transactions. However, we are concerned that the Exposure Draft (“ED”) contains changes that create undue complexity, costs, produces accounting results that are inconsistent with risk management strategies and in turn may not improve financial reporting. We also believe that it is unreasonable to ask companies to implement new processes required in this proposal, and potentially change the same processes again to adopt IAS 39 *Financial Instruments: Recognition and Measurement*. This is particularly troubling because the accounting for hedging activities in this ED diverge from the hedge accounting requirements currently in IAS 39, at a time when the Board should be moving toward convergence. Below are our detail views on the related topics proposed in this ED.

Hedged Risk

In general, derivatives can be designed to manage discrete risks, and the proposed change may disqualify some of the basic hedging strategies currently used in practice by companies, such as mitigating basic risks like interest rate and currency fluctuations. In cases where hedge effectiveness can be supported at the inception of the hedge, a company should be allowed to bifurcate the exposure and qualify for hedge accounting. The financial markets have bifurcated the interest rate exposure for prospective bond issuers, allowing issuers to hedge against interest rate movements prior to the issuance by utilizing derivatives, either a treasury lock or swap rate lock. The treasury lock hedges interest rate movement of United States Treasury or risk free interest rate

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movements (i.e. no credit risk mitigation) or the issuer can use a swap rate lock which includes not only the underlying movement of risk free rate movements (i.e. United States Treasuries) but also the credit spread risk. Investment grade issuers can positively correlate the swap spread (the difference between the swap rate and the Treasury rate) and their credit spread. The swap rate lock mitigates both the credit-spread risk in addition to the benchmark risk free interest rate. There will be issuers who cannot positively correlate the derivatives swap spread and their credit spread thus would be unable to demonstrate hedge effectiveness.

An investment grade company may enter into a forward starting swap using LIBOR as the benchmark to hedge a forecasted bond issuance. The swap can be decomposed into both the underlying benchmark treasury rate and the embedded credit risk of the interbank market players and these derivative instruments can be proven to be reasonably effective through a number of common practices. Additionally, the ability to enter into a transaction to mitigate interest rate risk associated with a company's Commercial Paper ("CP") program would no longer qualify for hedge accounting under the ED. However, much like the examples cited in the ED, the derivative utilized would create a synthetic fixed rate obligation when the company can more cost effectively raise capital in the CP market. Based on these examples, we would recommend that companies be allowed to retain the current practice of allowing bifurcating by risk exposure on foreign currency hedges when effectiveness of the hedge can be supported at the inception of the hedge.

Effectiveness

We support the efforts of the Board to change the effectiveness guidelines from highly to reasonably effective and eliminating the quantitative assessment of hedge effectiveness. However, we fail to see the rationale for the requirement to calculate ineffectiveness on every hedge relationship if a qualitative assessment can be prepared at the inception of the hedge that would document the amount of ineffectiveness will be insignificant to the financial statements. Under the current proposal, companies would have undue operational stress to calculate the ineffectiveness on an ongoing basis when it is known at inception and during the hedge relationship that the hedge ineffectiveness is insignificant to the financial results. We do not support the need to calculate and document the measurement of an insignificant ineffectiveness.

We believe that a top sided qualitative assessment can be developed to include a "hypothetical sensitivity analysis" that could be used to identify triggers when a hedging instrument would produce significant ineffectiveness to the financial statements, and thus no longer be reasonably effective. Consequently, we do not understand the Board's position that would require reassessment of effectiveness after the hedge relationship, only if circumstances suggest that the hedging relationship may no longer be reasonably effective. We contend that some form of a qualitative top sided assessment (i.e., quarterly monitoring) is required to determine if the circumstances have occurred that would result in the hedging relationship to no longer be reasonably effective.

Intercompany

We would like to provide comment on the added text in paragraph 40 of FAS No. 133 requiring that a forecasted transaction present an exposure to variations in cash flows that could effect reported earnings must be at the level being reported on. Intercompany transactions have a foreign exchange exposure and although do not have an immediate impact to the consolidated earnings at the time of the intercompany transaction, the intercompany transaction is critical to a company's supply chain and acts as a conduit for the transaction to the third party, which will impact the consolidated earnings.



Recording the hedge impact of the intercompany transaction prior to when the transaction impacts earnings does not reflect the economic reality of the transaction cost to the third party. The Board's intention is unclear as to why this change has been made and how much connection to a third party risk an intercompany transaction must exist to qualify the hedging instrument for hedge accounting.

Dedesignation of Hedge Relationships

The draft prohibits a company from removing a hedge designation, unless the hedge relationship no longer meets required hedging criteria in the Statement or the hedging instrument expires, is sold, terminated, or exercised. It is unclear if the Board's objective was to include or exclude DIG No. H15 *Foreign Currency Hedges: Using a Forward Contract to Hedge a Forecasted That Becomes Recognized* in this proposed change. We argue that companies should be allowed to continue to dedesignate a hedge relationship at the transaction date in instances where a foreign currency forward derivative hedges a forecasted foreign currency transaction through its cash settlement date, and the dedesignation date is stipulated at the inception of the hedge. Companies should continue to report the effective portion of the gain or loss on the derivative in OCI during the period prior to the transaction date, and all gains or losses after the transaction date are recorded to earnings and effectively offset the remeasurement of the foreign denominated asset or liability that is remeasured at spot exchange rates under paragraph 15 of FASB Statement No. 52 *Foreign Currency Translation*. We contend that the impact on the financial statement is aligned with the accounting principles described in FAS No. 133.

Thank you very much for taking our comments into consideration.

Sincerely,

Stephen J. Cosgrove
Vice President, Corporate Controller

John A. Papa
Vice President, Treasurer