



**PEPSICO**



LETTER OF COMMENT NO. 1

May 21, 2007

Mr. Robert H. Herz  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities" (FAS 133)

Dear Mr. Herz:

We are supportive of the FASB's recent announcement to consider whether to add a new project to its agenda addressing hedge accounting. We understand that in reaching this decision, the FASB will also discuss practice issues under FAS 133.

The ongoing difficulty in implementing FAS 133 is evident by the voluminous nature of the Standard itself. In addition, the magnitude of restatements over the past two years has been driven by incorrect application of the Standard, and a form-driven application of rules that are, at times, at variance with the way companies take operating decisions. As a result, we are a strong proponent of further discussion on this topic.

We, along with other companies and trade associations, participated in correspondence sent to the FASB in October 2005 requesting certain amendments to FAS 133. We provided a marked FASB Staff Position illustrating our recommendation to provide for the hedging of a component of a nonfinancial item. A copy of the letter is included herein.

We appreciate the opportunity to express our views and would be pleased to discuss our comments. Please do not hesitate to contact me at (914) 253-3406.

Sincerely,

Peter A. Bridgman  
Senior Vice President and  
Controller

cc: Richard Goodman, Chief Financial Officer  
Marie T. Gallagher, Vice President & Assistant Controller

October 27, 2005

Mr. Jason Jacobs  
Practice Fellow  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Dear Jason:

We appreciate the opportunity to discuss with you and Jeff Mahoney the request by our group to amend FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, (SFAS 133), to provide for the hedging of a component of a nonfinancial item. Similar bifurcation is permitted by SFAS 133 for the designated benchmark interest rate for financial items.

For many nonfinancial assets and liabilities and forecasted cash flows, a market index is a separately identifiable and determinable component of the price of the item. The changes in the market-indexed component of the item's price are, in many hedging relationships, closely related to the hedging derivative.

The attached mark-up of a FASB Staff Position illustrates our recommendation. If you have questions or clarifications, please do not hesitate to call Jula Kinnaird, National Grain Trade Council, (202) 842-0400, ext. 100.

Sincerely,

National Grain Trade Council  
ARAMARK Corp.  
Chicago Board of Trade  
ConAgra Foods  
Flowers Foods, Inc.  
General Mills, Inc.  
Kansas City Board of Trade  
Minneapolis Grain Exchange  
PepsiCo, Inc.

cc: Jeff Mahoney, FASB

Attachments

## **FASB STAFF POSITION**

**No. FAS 133-b**

**Title: Accounting for Non-Financial Hedging Relationships**

**Date Posted: November xx, 2005**

### **Issue**

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to address the designated risk in a hedge of a nonfinancial asset or liability (other than a recognized loan servicing right or a nonfinancial firm commitment with financial components) or a forecasted transaction. This FSP allows for the bifurcation of hedges of nonfinancial assets or liabilities or forecasted transactions into identifiable, measurable risks in a manner similar to hedges of financial assets and liabilities.

### **Background**

2. Paragraphs 21e and 29g of Statement 133 do not allow the risk being hedged to be anything other than the total change in fair value of a nonfinancial asset or liability or forecasted transaction, even though there may be market-indexed components of the price of a hedged item that are identifiable and separately measurable. For example, assume a food manufacturer would like to hedge its purchases of corn which it uses in the production of its products. The corn is purchased from growers with pricing based the CBOT corn future for the month tied to the month of delivery and use in manufacturing. The price also includes a basis which covers handling and storage costs from harvest month to the delivery month and delivery costs to the manufacturer's storage facilities. The risk of changes in the cash flows of CBOT corn futures has an identifiable and separately measurable effect on the price of the corn purchased from the growers. Therefore, the risk of changes in the CBOT corn future component would be a hedgable risk in a hedge of these corn purchases.

In another example, assume a bakery would like to hedge its purchases of flour. In the manufacturing process, wheat is milled into flour. The excess wheat is mill feed, a by-product. The flour manufacturer charges a predetermined fee to mill the wheat. The bakery's flour costs are determined by the following components:

- the price of wheat futures (the market-indexed component);
- basis, reflecting the location of the manufacturer's facility;
- the price of mill feed (credits to the bakery's cost of flour); and
- the manufacturer's profit margin.

The risk of changes in the price of wheat futures has an identifiable and separately measurable effect on the price of the flour purchased from the manufacturer. Therefore,

the risk of changes in the wheat futures component would be a hedgable risk in a hedge of these flour purchases.

These examples illustrate the market-indexed component pricing that exists for many raw materials purchased and energy consumed in the production of goods and delivery of services.

3. Questions have arisen as to whether the market-indexed component of the price of a hedged item is an identifiable and separately measurable risk that is able to be designated in a hedging relationship. This concept is similar to the bifurcation of risks available currently for the hedging of financial assets and liabilities as discussed in paragraph 21f of Statement 133.

#### **FASB Staff Position**

4. The FASB staff believes that an identifiable and separately measurable market-indexed component of a nonfinancial asset or liability may be designated as the hedged risk in a fair value or cash flow hedging relationship.

5. The Board has agreed to replace paragraph 21e of Statement 133 with the following:

21 e. If the hedged item is a nonfinancial asset or liability (other than a recognized loan servicing right or a nonfinancial firm commitment with financial components), the designated risk being hedged may be either (1) the risk of changes in the fair value of the entire hedged asset or liability (reflecting its actual location if a physical asset), or (2) the risk of changes in the fair value of an identifiable, separately measurable market-indexed component of the nonfinancial asset or liability. For a component to be considered market-indexed, there must be a derivatives market that is highly correlated with that component. Typical components include:

- the futures price of a commodity (the market-indexed component);
- basis (component based on local supply and demand, holding costs and transportation costs); and
- other pricing elements (for example, any co-product created, any by-product created, pre-set margin of the manufacturer).

6. The Board has agreed to modify paragraph 29g of Statement 133 with the following:

29 g. If the hedged transaction is the forecasted purchase or sale of a nonfinancial asset, the designated risk being hedged is (1) the risk of changes in the functional currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates, (2) the risk of changes in the cash flows relating to all changes in the purchase price or sales price of the asset reflecting its actual location if a physical asset (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), or (3) the risk of changes in the cash flows relating to an identifiable, separately measurable

market-indexed component of the forecasted purchase of the nonfinancial asset. For a component to be considered market-indexed, there must be a derivatives market that is highly correlated with that component. Typical components include:

- the futures price of a commodity (the market-indexed component);
- basis (component based on the risk of changes in price due to changes in local supply and demand); and
- other pricing elements (i.e., any co-product created, any by-product created, pre-set margin of the manufacturer).

### **Disclosure**

7. An entity should disclose, in addition to the items required by paragraph 44 of Statement 133, the specific market-indexed components designated as the hedged risks in hedging relationships.

### **Effective Date and Transition**

8. The guidance in this FSP shall be applied to hedging relationships designated or redesignated beginning after December xx, 2005.

Amended FASB Statement No. 133.

-Deleted words are in brackets ( )

(References to Implementation Issues should not be deleted).

-Additions are underlined ( )

21. e. If the hedged item is a nonfinancial asset or liability (other than a recognized loan servicing right or a nonfinancial firm commitment with financial components), the designated risk being hedged [is the risk of changes in the fair value of the entire hedged asset or liability (reflecting its actual location if a physical asset). That is, the price risk of a similar asset in a different location or of a major ingredient may not be the hedged risk. Thus, in hedging the exposure to changes in the fair value of gasoline, an entity may not designate the risk of changes in the price of crude oil as the risk being hedged for purposes of determining effectiveness of the fair value hedge of gasoline.] may be either (1) the risk of changes in the fair value of the entire hedged asset or liability (reflecting its actual location if a physical asset), or (2) the risk of changes in the fair value of an identifiable, separately measurable market-indexed component of the nonfinancial asset or liability. For a component to be considered market-indexed, there must be a derivatives market that is highly correlated with that component. Typical components include:

- the futures price of a commodity (the market index component);
- basis (component based on local supply and demand, holding costs, and transportation costs); and
- other pricing elements (for example, any co-product created, any by-product created, pre-set margin of the manufacturer).

29. g. If the hedged transaction is the forecasted purchase or sale of a nonfinancial asset, the designated risk being hedged is (1) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates, [or] (2) the risk of changes in the cash flows relating to all changes in the purchase price or sales price of the asset [( )reflecting its actual location if a physical asset( )], (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), or (3) [not] the risk of changes in the cash flows relating to [the purchase or sale of a similar asset in a different location or of a major ingredient. Thus, for example, in hedging the exposure to changes in the cash flows relating to the purchase of its bronze bar inventory, an entity may not designate the risk of changes in the cash flows relating to purchasing the copper component in bronze as the risk being hedged for purposes of assessing offset as required by paragraph 28(b)] an identifiable, separately measurable market-indexed component of the forecasted purchase of the nonfinancial asset. For a component to be considered market-indexed, there must be a derivatives market that is highly correlated with that component. Typical components include:

- the futures price of a commodity (the market-index component);
- basis (reflecting component based on the risk of changes in price due to changes in local supply and demand); and
- other pricing elements (i.e., any co-product created, any by-product created,

pre-set margin of the manufacturer).  
[A 11, B15]