

August 15, 2008

Technical Director  
Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, CT - 06856



LETTER OF COMMENT NO. 59

Re – Proposed Statement of Financial Accounting Standards: Accounting for Hedging Activities, an amendment of FASB Statement No. 133.  
File Reference No. – 1590-100

Dear Sir:

International Business Machines Corp. appreciates the opportunity to respond to the proposed Statement of Financial Accounting Standards: Accounting for Hedging Activities, an amendment of FASB Statement No. 133 (hereafter referred to as "FAS 133R" or the "Proposed Statement").

We generally support the Board's decision to undertake this project to simplify the accounting requirements and to resolve major practice issues that have arisen in this area under the current guidance (hereafter referred to as "FAS 133"). While the Proposed Statement would change current practice in many areas, we do not have any significant objections to the majority of these amendments and believe that the transition guidelines provide adequate time to appropriately implement these changes.

However, we would like to seek further clarification on the proposed amendment to paragraph 40, which states that for foreign currency cash flow hedges of forecasted transactions, "the requirement in paragraph 29 (c) that the forecasted transaction presents an exposure to variations in cash flows that could affect reported earnings must still be met at the level being reported on. (For example in the financial statements of a consolidated entity, there would need to be a potential earnings effect that survives consolidation.)"

While we understand that this clarification was directed towards hedges of inter-company transactions, it is not entirely clear from the proposed language to what extent this clarification would change current practice in this area.

Paragraph 40 of FAS 133 allows entities to hedge forecasted inter-company transactions including forecasted inter-company sales, purchases and royalty receipts as long as certain qualifying criteria as set forth in paragraph 29 are met.

The Basis of Conclusions section (paragraphs 482-486) of FAS 133 provides the rationale for allowing hedge accounting for forecasted inter-company transactions. Specifically, according to paragraph 484, "an inter-company transaction that is denominated in a currency other than the entity's functional currency gives rise to a

transaction gain or loss if exchange rates change. A forecasted inter-company transaction that is expected to be denominated in a foreign currency can be viewed as giving rise to the same kind of foreign currency risk. Therefore pursuant to this Statement, a forecasted inter-company transaction that presents an exposure to foreign currency risk that otherwise satisfies the criteria for a foreign currency cash flow hedge is eligible for hedge designation as a hedged transaction."

In addition, Derivative Implementation Group Issue No. H13, *Reclassifying into Earnings Amounts Accumulated in Other Comprehensive Income Related to a Cash Flow Hedge of a Forecasted-Foreign Currency-Denominated Inter-company sale*, ("DIG H13") explains that a forecasted Yen denominated inter-company sale between a Euro functional and a Yen functional subsidiary of a USD functional parent would satisfy all criteria for a foreign currency cash flow hedge (per paragraph 40 and 29) and as such would be accorded hedge accounting treatment in the consolidated financial statements of the USD parent.

Based on the above, it is clear that according to FAS 133, forecasted inter-company transactions (such as sales, purchases and royalty receipts) give rise to foreign currency risk at the consolidated level similar to recognized foreign currency denominated assets and liabilities and as such are eligible for hedge accounting in the consolidated financial statements. It is our understanding this unequivocal position as expressed in SFAS 133 was intentionally based on the fundamental functional currency concepts as expressed in Statement of Financial Accounting Standards No. 52, *"Foreign Currency Translation"* (hereafter referred to as "FAS 52"). FAS 52 in substance, recognizes a surviving "real" foreign currency based income statement risk on any transaction between two consolidated entities operating in different functional currencies.

According to Paragraph A38 of the Proposed Statement, clarifying amendments to paragraph 40 were provided because of the need to address differences between the intent of the guidance in paragraphs 40 and how practice developed. Given the guidance in FAS 133, pursuant to paragraph 40, 482-486 and DIG H13 (and the underpinnings of FAS 52), it is not clear how the practice with respect to hedges of inter-company forecasted transactions is different from the intent of the current guidance. As such, we would request that the Board further clarify the statement in A38.

Further, while Appendix C of the Proposed Statement notes that DIG H13 will be revised to reflect the amendment to paragraph 40, this revised version has not been included in the Proposed Statement. Additionally, the language regarding forecasted inter-company transactions in the existing Basis of Conclusions (with particular reference to paragraph 482-486) has not been addressed by the Proposed Standard. Given that the Proposed Statement is silent with respect to conclusions reached in the current guidance regarding hedge accounting eligibility of forecasted inter-company transactions, it is hard to determine how and to what extent current practice may be affected by the proposed clarification to paragraph 40.

As noted above, we believe the current practice of hedging forecasted inter-company transactions at the consolidated level is in compliance with FAS 133. Therefore any change to paragraph 40 that might result in some or all of the forecasted inter-company transactions becoming ineligible for hedge accounting would constitute not a clarification of existing guidance as suggested in paragraph A38, but an amendment to FAS 133 that would have a significant impact on the financial reporting community, as hedges of inter-company forecasted transactions are commonplace in a multinational environment.

In light of the potential impact of any change to current practice in this area, we note that the Board's deliberations on this project did not mention any proposed changes to this area. Additionally, we also note that one of the Board's scope related decisions regarding this project as stated in paragraph A4 of the Basis of Conclusions in the Proposed Statement is that "the types of items and transactions currently eligible for hedge accounting under FAS 133 would continue to be eligible under the proposed standard." If the proposed clarification to paragraph 40 were to significantly change current practice, we believe that it would not only be inappropriate for an amendment of this significance to be included in the exposure draft without any prior discussions or even an adequate explanation for the change, but the amendment would in fact be in direct contradiction to the Board's own stated objectives regarding the scope of this project.

Given the lack of clarity with respect to the paragraph 40 amendment, we believe the Board should further elaborate on this issue in the Proposed Statement and illustrate using relevant examples, how this proposed clarification would amend current practice. Additionally, if the proposed clarification does significantly amend current practice, the Basis of Conclusions in the Proposed Statement should include a more thorough discussion of the rationale for this change, particularly in light of the Board's stated objectives regarding the scope of this project.

We also believe that the amended draft of FAS 133R with the suggested changes as noted above should be re-exposed to the public so that the financial reporting community can fully understand and appropriately react to any proposed changes in this area before the Proposed Statement is finalized.

If you have any questions about our comments or wish to discuss any of the issues raised in this letter please feel free to contact us.

Sincerely,

Richard J. Carroll  
IBM Chief Accountant