

**From:** [Gregg Nelson](#)  
**To:** [Director - FASB](#)  
**Subject:** File Reference No. 1810-100  
**Date:** Tuesday, September 28, 2010 3:42:24 PM  
**Importance:** High

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(Sent via email to [director@fasb.org](mailto:director@fasb.org))

September 28, 2010  
Russell G. Golden, Technical Director  
Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, CT 06856

Re: File Reference No. 1810-100 – Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815) – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Mr. Golden:

International Business Machines Corporation (“IBM”, “the company”, or “we”) appreciates the opportunity to comment on the proposed Accounting Standards Update, Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities (the “proposed ASU”).

IBM’s global capabilities include services, software, systems, fundamental research and related financing. The company operates in multiple functional currencies and is a significant lender and borrower in the global markets. Resulting exposures are mitigated through the use of derivatives and other risk management procedures. Therefore, although the company is not a financial services institution, it will be significantly impacted by the proposed ASU.

We generally support the Board’s decision to undertake this project to simplify the accounting requirements and to resolve practice issues that have arisen under the current guidance. However, we are disappointed with the lack of convergence between the Financial Accounting Standards Board (the “FASB”) and the International Accounting Standards Board (the “IASB”). Financial instruments are a key component of the joint projects initiative under the Boards’ Memorandum of Understanding (the “MoU”). However, the proposed ASU diverges in many significant respects from the classification, measurement and credit impairment guidance proposed by the IASB. We believe it is imperative that the FASB and IASB focus on developing a single converged financial reporting model for financial instruments. Anything short of that outcome will create an unlevel playing field between IFRS and US GAAP filers and will exacerbate comparability for financial statement users. Furthermore, it will inevitably lead to other issues, including the potential of multiple implementations, for US GAAP filers if they are required to adopt IFRS in the future.

Our specific comments related to the proposed ASU are expressed below.

Fair value measurement

We do not support the classification and measurement approach contained in the proposed ASU. On this matter, we agree with the minority FASB members who support a mixed measurement model consisting of fair value and

amortized cost for financial instruments. Consistent with the IASB approach, we believe that amortized cost should be the measurement attribute for instruments that are held for collection or payment of contractual cash flows. This measurement attribute is more consistent with how users evaluate investment decisions and how businesses are managed. We do agree that fair value with subsequent changes in fair value recognized in net income is the most appropriate reporting basis for instruments held in trading portfolios.

This view is supported by an independent survey performed by PricewaterhouseCoopers ("What Investment Professionals Say About Financial Instrument Reporting, June 2010"), which indicates that the majority of investment professionals do not support fair value as the default model. Given that the overwhelming majority of financial statement users and preparers do not support the principles in the proposed ASU, we recommend that the FASB reconsider its decision to require fair value as the primary measurement attribute in the financial statements.

Notwithstanding our view that fair value should not be the primary measure for financial instruments held for the collection or payment of contractual cash flows, we agree that fair value information is useful for certain financial instruments in this category, such as own debt. Therefore, we recommend that the fair value of certain instruments be disclosed in the footnotes to the financial statements.

#### Financial statement presentation

As mentioned above, we support the disclosure of fair value information for certain financial instruments such as own debt in the footnotes to the financial statements. However, we believe that the proposed new presentation requirements will obscure the face of financial statements with extensive disaggregation that will detract from the relevant financial measures. Additionally, we believe that timely preparation of the financial statements for earnings release and press release issuance, which for IBM is normally 18-19 days after the balance sheet date, will be in jeopardy given the onerous financial statement presentation requirements included in the proposed ASU. Therefore, we recommend changing the provisions in the proposed ASU to provide the additional information in the footnotes rather than on the face of the financial statements, especially where the company's business model is to hold financial instruments for collection or payment of contractual cash flows.

Clear, concise and adequate presentation and disclosure is vital to high quality financial reporting. Accordingly, providing this information through footnote disclosure will satisfy the needs of users without overwhelming them with detail on the face of the financial statements.

#### Own debt

For most debt that is issued for financing purposes and requires the payment of contractual cash flows, fluctuations in fair value during the holding periods are not ultimately realized; therefore, we believe that amortized cost is the most appropriate measurement basis for own debt. The classification criteria in paragraphs 28-30 in the proposed ASU create a bright-line test which, in our view, would exacerbate comparability among entities. Even within the company's own debt portfolio inconsistencies may occur because the "50% test" on issuance date could lead to multiple measurement approaches over time on debt that is issued under the same business model. We view such a bright-line test as inappropriate for classification purposes and therefore recommend eliminating it. We also note that the elimination of bright-line tests would be in line with the proposed leasing model under ASC 840.

#### Loan commitments

It is our understanding that, under paragraph 25 of the proposed ASU, loan commitments issued by potential lenders would be recognized at fair value and classified in a manner that is consistent with how the loan would be classified if and when it is funded. We recommend further clarification on whether loan commitments as defined on page 30 of the proposed ASU are limited to loan commitments by creditors such as financial institutions or whether they are meant to encompass commitments entered into by commercial companies. For example, it is unclear whether commitments to customers to finance future purchases and/or open credit lines for business partners who buy inventory would fall under this definition of loan commitments.

#### Factoring of receivables

It is our understanding that, under paragraph 33 of the proposed ASU, receivables arising in the normal course of business that are due in customary terms not exceeding one year, which are being factored and therefore do not meet the criteria in paragraph 21, would have to be measured at fair value through earnings instead of at amortized cost. Since factoring of receivables is not a trading activity and should therefore not be measured at fair value we recommend the Board amend and broaden the current business strategy wording in paragraph 21 to allow for strategies such as factoring.

#### Equity method accounting

We do not agree with the proposal to limit the use of the equity method of accounting to investments that are "related" to the entity's consolidated business for the following reasons:

- Consolidation of all entities where control is present is required regardless of differences between the parent and subsidiary's business operations. Equity method accounting should be required where significant influence is present and the nature of the investment is for long-term strategic purposes, regardless of differences in business operations.
- The proposal will adversely affect the reliability of reported results. Many of the valuations for these investments would be based on "Level 3" valuation techniques. Moreover, valuation assumptions may be based on stale information due to typical lags in the availability of financial data.

We recommend excluding equity method investments from the scope of this proposed ASU.

#### Impairment model

While we support the introduction of an impairment model that requires earlier recognition of expected credit losses, there are significant operational and conceptual issues associated with the proposed credit impairment model.

We do not agree with the proposal to limit the credit loss data to only historical events and current conditions when determining the amount of expected credit losses. Investors rely on management to develop their best estimate of credit losses. In practice, such estimates are based on historical and current economic trends, published statistical data, borrower specific data and reasonable forward looking expectations. The proposed calculation of expected credit losses differs fundamentally from the inherent expected cash flows that underpin the fair value of financial instruments, as well as a market participant's overall view of credit risk. The notion of expected credit losses, whether based on expected cash flows, statistical data or implicit in a quoted price, inherently considers how

expectations of future economic conditions affect current and historical conditions. Determining and reporting credit losses based on a static or historical view of credit exposure will cause an enterprise to misstate its exposure to credit risk and result in credit loss reserves that lag changes in the credit cycle.

In addition, although based on expected cash flows, the proposed model requires a separate reserve methodology for purchased financial assets. In a credit impairment framework based on expected cash flows, it is no longer necessary to separately distinguish purchased credit impaired financial assets. Accordingly, we do not believe there is a conceptual basis to differentiate between originated and purchased financial assets. Therefore, to simplify the credit impairment framework, we recommend that the Board develop a more operationally efficient model to address the issues related to purchased financial assets with specifically identified credit impairment.

Furthermore, we do not support calculation of interest income by applying the effective interest rate to the amortized cost balance net of the allowance for credit losses. This change would require significant and costly system changes to accommodate this new recognition model. Additionally, we seek further clarification on how to account for credit losses that are spread and maintained across loan portfolios. We recommend a simplified approach that would allow top side adjustments to interest income.

#### Hedging

In view of the difficulties experienced by preparers in applying hedge accounting, we support the FASB's overall efforts to simplify accounting for hedging activities. We support eliminating the high effectiveness threshold, as well as streamlining hedge documentation through the elimination of the current initial and ongoing quantitative effectiveness assessment requirements.

However, we believe that the proposed changes will create interpretive issues regarding the definition of "reasonably effective" and when a quantitative assessment of effectiveness is necessary. Without additional guidance, there may be an implicit requirement for preparers to perform quantitative assessments to avoid "second guess" risk or to prove the qualitative assertions. The Basis for Conclusions notes that the need for quantitative assessments should be rare. However, we believe the final standard should explicitly remove the quantitative analysis from the determination of hedge effectiveness. A qualitative-only approach will be more effective in determining effectiveness and further simplify the hedge accounting model. Such guidance would ensure that quantitative assessments are only applied in very rare circumstances when management's judgment indicates the need to support or supplant the qualitative assessment. We believe that our current corporate governance and risk management procedures would suffice to qualitatively ensure that our hedging programs are reasonably effective.

Further, we do not view the ability to de-designate hedging relationships to be problematic or an area of abuse under the current model. Hedge accounting by its nature is elective and, therefore, the ability to discontinue it is consistent with this notion. The objective of dynamic hedging strategies is to promote effective risk management by ensuring the hedging relationship contemplates the changing economic conditions of the hedged item. Additionally, the proposal is unclear as to whether net investment hedges are affected by the elimination of voluntary de-designations. Due to the nature of the underlying, net investment hedges

often involve strategies that include de-designation and re-designation of both derivative and non-derivative instruments. Accordingly, we believe the final standard should specifically exclude net investment hedges from the prohibition against de-designation/re-designation strategies.

Finally, we recommend that the final standard only require prospective application of the proposed hedge accounting provisions to hedging relationships that exist as of the implementation date in light of the potential long term nature of some hedging relationships. Certain hedge accounting relationships that exist at the implementation date will be eliminated and application of the transition guidance would require companies to assess and measure hedge effectiveness for historical periods for which information may be difficult or impractical to obtain.

If you have any questions about our comments or wish to discuss any of the issues raised in this letter please contact Gregg Nelson at (914)-766-3190 or Joerne Schroedter-Albers at (914)-766-3678.

Sincerely,

Richard J. Carroll  
IBM Chief Accountant