

## The Association of Corporate Treasurers

Comments in response to  
***Accounting for Financial Instruments and  
Revisions to the Accounting for Derivative  
Instruments and Hedging Activities***  
**FASB Exposure draft**  
May 2010

30<sup>th</sup> September 2010

### The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website [www.treasurers.org](http://www.treasurers.org).

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, and our Policy and Technical Committee.

### General

The ACT welcomes the opportunity to comment on this matter.

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### Response

We are writing to you in response to the invitation by the International Accounting Standards Board ("IASB") to comment on the FASB proposed guidance for accounting for financial instruments. We do not intend to comment on the detailed questions in the proposed guidance however we wanted to comment on the broad approach taken in the proposed guidance towards classification and measurement of financial liabilities as it could affect our members and the non financial companies in which they work.

We disagree with the approach presented in the proposed guidance primarily because we do not think that fair value is the measurement attribute that provides the “most useful, transparent, and relevant information about an entity’s exposure to financial instruments.” We believe that a company’s business model for managing the financial instruments should be the primary criteria for classification and measurement of financial instruments. In that we agree with approach taken by IASB in IFRS 9 “Financial Instruments” for financial assets and in their subsequent discussions for financial liabilities.

For example when UK corporates raise debt with fixed interest rates, in vast majority of cases their primary concern is with funding the underlying business and removing interest rate volatility rather than taking a speculative position on interest rates. Such debt would typically be medium to long term, and either matched as close as possible with the cash flow profile and cost assumptions of the underlying corporate business or have staggered maturities to mitigate the funding risk. These are some of the key consideration in good practice corporate treasury whose overall objective is to support the core corporate business and mitigate the inherent and exogenous financial risks. In other words when raising debt our members are not trying to take positions in the interest rate swap markets, nor create a position that would generate income statement volatility at each reporting date, in fact they are trying to achieve exactly the opposite, to remove interest volatility and risk from their company.

In practice our members may sometimes agree to prepayment and other options embedded in their debt. That could be done to decrease the cash interest cost of the company - at the expense of taking on additional financial risk. Where such embedded options (or other embedded derivatives) are not economically closely related to the host debt contract they do not, in our view, change the overall characteristics of corporate debt to an extent that would justify requiring that it is carried at fair value with all changes in fair value reported through the income statement.

A company that has mitigated its financial risks by fixing debt coupon cash flows, but failed to comply with the criteria in paragraphs 21-23 and 28-30 of the proposed guidance (for example because the debt is treated as a hybrid instrument) would then have to report large gains and losses in the income statement, where in fact it was following good corporate risk management practice. We therefore find it extraordinary that in accordance with the proposed guidance large amounts of corporate debt would indeed be required to be carried at fair value in the statement of financial position with changes reported in the income statement, although the debt will actually be settled by paying contractual interest and principal cash flows which are often fixed throughout its life. This is because corporates (like most other entities) seldom transfer their financial liabilities to third parties but rather settle them with the original counterparty. We therefore do not see how reporting information about the changes fair value of most corporate financial liabilities on the face of the statement of financial position and in the income statement would be of any use to current and prospective shareholders, analysts, tax officials, lenders or the general public.

As you acknowledged in the summary to the proposed guidance the IASB, in its recent meetings, tentatively agreed to retain embedded derivatives guidance for financial liabilities, which would lead to separation and mark to market of those embedded derivatives that are not closely related to the host debt contract, while the host contract itself would remain at amortised cost. Whilst we disagree with the requirement to separate embedded derivatives from some of the market-accepted coupon structures, overall we (along with the majority of other respondents to IASB) agree with their approach because, as stated above, we also agree that primary determinant for financial instruments classification is the entity’s business model for managing financial instruments, with contractual cash flow characteristics of financial instruments being the

secondary characteristic. Given the way non-derivative financial liabilities such as debt with embedded derivatives are incurred and managed by corporates we believe that corporate debt in a majority of cases should be carried at amortised cost because that is the measurement attribute that provides the “most useful, transparent, and relevant information about an entity’s exposure to financial instruments” such as issued corporate debt. We therefore support IASB’s approach in this area and disagree with the approach taken in the FASB proposed guidance.

## The Association of Corporate Treasurers

The ACT is the international body for finance professionals working in treasury, risk and corporate finance. Through the ACT we come together as practitioners, technical experts and educators in a range of disciplines that underpin the financial security and prosperity of an organisation.

The ACT defines and promotes best practice in treasury and makes representations to government, regulators and standard setters.

We are also the world's leading examining body for international treasury, providing the widest scope of benchmark qualifications and continuing development through training, conferences and publications, including *The Treasurer* magazine and the annual *Treasurer's Handbook*, and online.

Our 3,600 members work widely in companies of all sizes through industry, commerce professional service firms.

Further information is available on our website (below).

Our policy with regards to policy and technical matters is available at <http://www.treasurers.org/technical/manifesto>

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