The Hershey Company

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Susan Cosper, Technical Director
Financial Accounting Standards Board
401 Merrit 7
P. O. Box 5116
Norwalk, CT 06856-5116

Submitted via electronic mail to director@fasb.org

Re: File Reference: No. 2011-175, Discussion Paper: *Selected Issues about Hedge Accounting*

Dear Ms. Cosper:

We appreciate the opportunity to provide our comments, concerns and suggestions on the Discussion Paper: *Selected Issues about Hedge Accounting* (the "DP"). Generally, we support the objectives of the DP to develop a common hedge accounting standard for U.S. GAAP and IFRS, as well as to improve and simplify the standards of accounting for hedging activities. The objective of our correspondence is to address Question 7, specifically as follows:

> *Do you believe that the proposed criteria are appropriate when designating a component of an item as a hedged item? If not, what criteria do you suggest? Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to determine when the criteria of separately identifiable and reliably measurable have been met? If not, please describe what additional guidance should be provided.*

We believe that the proposed standards are appropriate and substantially define the criteria to be used in evaluating whether a risk component may be designated as a hedged item. However, we believe that the proposed standard, in conjunction with the related appendices, provides insufficient guidance for use in determining when the criteria for "separately identifiable" and "reliably measurable" have been definitively met. As a result, we recommend the incorporation of illustrations whereby proposed risk components qualify and, conversely, fail to meet the criteria for hedge designation on the basis of satisfying the "separately identifiable" and "reliably measurable" qualifications. Although references to the impending superseded IAS 39: *Financial Instruments: Recognition and Measurement* standard provide an adequate example defining the concepts of “separately identifiable” and “reliably measurable,” we believe that the inclusion of such examples within the new standard would ensure consistent application of the principles of evaluation for hedge designation of risk components.

The Hershey Company is the largest producer of quality chocolate in North America and a global leader in chocolate and sugar confectionery products. We purchase many different commodities for our business, including cocoa products, sugar, dairy products, peanuts, almonds, corn sweeteners, natural gas and fuel oil. Cocoa products, including cocoa liquor, cocoa butter and cocoa powder, are the most significant inputs that we use and are generally purchased from third party suppliers. We also purchase chocolate paste for use in our manufacturing process and finished good items, which are ready for resale.

The cost of chocolate paste, and finished goods items are dependent on and will change based upon changes in the costs of the commodities used to make them. The cost of these commodities (cited above) have historically been subject to wide fluctuations attributable to a variety of factors, but have active futures, options or forward physical markets that can be used to hedge future costs. We participate in these markets to provide visibility into our future input costs, and to take advantage of favorable purchasing opportunities.

Current U.S. GAAP permits entities to hedge the risk of overall changes in fair value of nonfinancial assets and prohibits the practice of hedging other individual risks, including the risk of changes in value for a principal ingredient or component. Specifically, ASC Subtopic 815-20-25-15(i) provides for the following with regard to cash flow hedging activities:

> *If the hedged transaction is the forecasted purchase or sale of a nonfinancial asset, the designated risk being hedged is either of the following:*
>
> 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), 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 815-20-25-75(b).*

Application of this standard adversely impacts our ability to use derivatives, such as commodity futures contracts, to hedge commodity cost changes in products purchased from third parties, even though the risk of commodity cost changes is no different than the risk we would have if were manufacturing the product ourselves. This is because a high correlation of the change in the total cost of the procured item (i.e., chocolate paste and finished goods) is not achieved as the item procured is more complex (i.e., a high correlation with the change in the price of cocoa futures exists for cocoa products but does not exist for chocolate paste because the cost of chocolate paste also includes sugar, milk, labor and overhead).

In recent years, as we have realigned our manufacturing supply chain and contracted with more third party suppliers, our ability to hedge these commodity price risks has been reduced and, in some cases, we have incurred additional administrative costs to develop tolling arrangements with third parties, where we own the raw materials and the third party converts them to the desired intermediate products, such as chocolate paste, or finished goods.

Tolling arrangements add complexities and costs across the manufacturing, accounting and administrative processes of our business and that of our suppliers (which we ultimately pay for). This forces us to choose between higher administrative costs and foregoing hedging opportunities.

We believe that the standards included in the IASB Exposure Draft: *Hedge Accounting* (the "ED") that permit the designation of risk components as hedged items for nonfinancial assets would help us to significantly simplify the process, resulting in considerable cost savings. In addition, we believe that the proposed standard would enable us to better hedge risks contained in third party manufacturing agreements that we do not hedge today because of the significant complexities involved or because of the inability to qualify for hedge accounting under current GAAP. Specifically, the IASB ED (paragraph 18) provides for the following:

> *An entity may designate all changes in the cash flows or fair value of an item as the hedged item in a hedging relationship. An entity may also designate as the hedged item something other than the entire fair value change or cash flow variability of an item, i.e., a component. An entity may designate the following types of components (including combinations) as hedged items:*
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> *(a) only changes in the cash flows or fair value of an item attributable to a specific risk or risks (risk component), provided that the risk component is separately identifiable and reliably measurable (see paragraphs B13-B18); risk components include a designation of only changes in the cash flows or the fair value of a hedged item above or below a specified price or specified rate (i.e., a 'one-sided' risk)*
>
> *(b) one or more selected contractual cash flows*
>
> *(c) nominal components, i.e., a specified part of an amount of an item (as set out in paragraphs B19-B23).*

In summary, we believe that current U.S. GAAP accounting standards do not properly consider the cost linkage of clearly identifiable components of purchased items and the needs of companies to hedge them, resulting in higher product costs and higher administrative costs in our business.

As a result, we strongly support the adoption of paragraph IN18 (and related appendices) from the IASB ED, including the enhanced exhibits described above, and strongly urge the FASB to consider our suggestions in further deliberations related to hedge accounting.

We appreciate this opportunity to provide our views on the DP. Please contact me if you have any questions or would like to discuss our comments and concerns.

Sincerely,

David W. Tacka
Vice President
Chief Accounting Officer

cc: Bert Alfonso
Senior Vice President, Chief Financial Officer