From: <u>Gregg Nelson</u>
To: <u>Director - FASB</u>

Subject: File Reference No. 2012-200, Proposed Accounting Standards Update: Financial Instruments (Topic 825) -

Disclosures about Liquidity Risk and Interest Rate Risk

Date: Tuesday, September 25, 2012 12:52:15 PM

Importance: High

September 25, 2012

Ms. Leslie F. Seidman, Chairman Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

(sent via e-mail to director@fasb.org)

Re: File Reference No. 2012-200, Proposed Accounting Standards Update: Financial Instruments (Topic 825) - Disclosures about Liquidity Risk and Interest Rate Risk

Dear Ms. Seidman:

The International Business Machines Corporation ("IBM" or "the company") appreciates the opportunity to comment on the proposed Accounting Standards Update: Financial Instruments (Topic 825) – Disclosures about Liquidity Risk and Interest Rate Risk (the "proposed ASU" or "exposure draft (ED)").

Overall, we are supportive of the objective to provide users decision useful information about liquidity and interest rate risk. However, in our view, the current SEC disclosure requirements regarding liquidity and interest rate and market risks are appropriate. We do not feel that creating a set of additional disclosures that are designed in a "one-size-fits-all" approach and presenting these disclosures in the financial statements as opposed to the Management Discussion and Analysis (MD&A) will deliver decision useful information to users. Due to its prescriptive nature, the proposed ASU may produce disclosures that may not be appropriate for a company's business model and will clearly have a level of overlap with the existing MD&A disclosures. We encourage the Board to revisit these requirements with an objective of enhancing the existing disclosures that will result in an integrated discussion of an entity's liquidity and interest rate risk that will be meaningful to investors.

In addition, we are concerned about the implications of this proposal on companies that maintain a captive financing entity, such as IBM. We believe that outreach is one of the most effective tools utilized in standard setting, however, we are concerned that the outreach performed on this proposal was limited to only twenty preparers (page 2 of the ED) and may not have included a sufficient number of entities that have a captive financing segment that is primarily used to support the sale of a company's products and services.

IBM currently consists of five reportable segments. Our Global Financing segment provides client and commercial financing to support the sales of the products and services of our other reportable segments. To provide additional transparency to investors, the company reports and measures the financing unit as a stand-alone entity. We believe that Global Financing

would meet the definition of a "financial institution" as described in the ED. Therefore, as a reportable segment that qualifies as a financial institution, this segment would have to provide the disclosures for a financial institution. This raises a couple of key concerns with the proposed ED.

First, the company has a strong centralized Treasury function that manages its liquidity and related risks at the consolidated level and not at a reportable segment level. As a result, the debt that is reported in our Global Financing segment is primarily intercompany debt issued by the Treasury function. A series of disclosures focused on intercompany amounts would not be useful to investors. Secondly, the financing services that this unit provides are provided by a significant number of other companies in support of their products and services. Therefore, these companies manage the same risks associated with their financing assets and liabilities. However, in many cases, these entities do not present their financing activities in a separate reportable segment. Under the ED, these consolidated entities would be considered non-financial institutions that would not have to provide financial institution disclosures. Though economically, the structure and purpose of their financing services would be identical to IBM's the presentation would differ. This raises the question of comparability and whether a scope definition built around a reportable segment is appropriate.

For these reasons, the company believes that the disclosure requirements in the proposed ASU for both financial and non-financial institutions are overly prescriptive. If the requirements are adopted as proposed, the company would need to provide additional non required information to prevent confusion for users. For instance, the ED provides that the liabilities of a financial institution segment and the non-financial institution segments should be disclosed separately. However, in many cases, for captive financing entities, as indicated above, much of the disclosure would focus on intercompany transactions (given the intercompany debt balances that would exist between a financing segment and all other segments (not considered financial institutions)). In IBM's case, we would need to provide additional consolidated disclosures not required by the ED to assist users in clearly understanding the relationships.

While a captive financing entity may meet the literal definition of a financial institution as described in paragraph 825-10-50-23A, it does not fit effectively into the prescribed disclosures, especially when its balance sheet contains significant intercompany activity. We request that the Board revisit the scoping requirements in the proposed ASU and give entities with captives of this type that exist only to support the parent's sales flexibility to provide users with more meaningful disclosures at the consolidated level.

Other Issues regarding the Exposure Draft:

1. Liquidity Risk and Interest Rate Risk

The exposure draft separates entities and segments into two categories: financial institutions and non-financial institutions. The guidance in paragraphs 825-10-50-23A and B would require that a financing segment be reported as a financial institution. As discussed above, we have concerns with this requirement and the resulting disclosures.

• The ED states that a financial institution has a strategic imperative to match the maturity of its financial assets and liabilities. The ED requires an assessment be made to determine if a particular segment or group of segments should be disclosed as a financial institution. The proposed ASU acknowledges that a non-financial institution may use

operational cash to meet its financing needs. Conceptually, the ability of the consolidated entity to use operational cash to meet the debt liabilities issued on behalf of its captive financing entity is ignored by the ED. For example, a captive financing entity may have financial assets with an average duration of five years, while the consolidated parent may have financial liabilities that average a longer duration. A consolidated entity may decide that this mismatch is appropriate because a portion of the debt issued by the corporation is not on behalf of its financing entity. It may be in support of capital costs, acquisitions or other operating activities of the non-financial entity. These types of decisions are made as part of its global cash and risk management program. We believe a user of the proposed disclosures would be better served in understanding the maturities of the external debt versus the consolidated financial assets.

• The ED requires separate disclosure for a reporting segment that qualifies as a financial institution. In many cases a financing segment holds debt in support of sales of products and services of the consolidated entity. However, in many cases, as noted earlier, the debt profile of the captive financing segment is in the form of intercompany debt issued on behalf of the financing segment by other legal entities within the consolidated entity. We do not believe presenting intercompany debt is particularly meaningful to an understanding of the entity's liquidity. A more meaningful disclosure would be to provide total consolidated debt of the corporation compared to the financial assets. All of the company's debt (including the financing related debt) could be presented on the cash flow obligation table on a consolidated basis. We believe that the requirement to treat a captive commercial financing segment as a financial institution will not provide users with decision useful information. We would support a standard more closely aligned to IFRS 7, Financial Instrument Disclosure, which does not require this distinction for financing segments. If the Board cannot align its proposal with IFRS 7, then we recommend that the Board permit entities with captive financing segments to present these disclosures on a consolidated basis if this presentation would be more meaningful to users.

2. Comparison with disclosure requirements under IFRS 7, Financial Instrument Disclosure

While the company understands that the ability to compare financial information across organizations enhances the qualitative characteristics of financial information to users, the company notes that there should be a balance between the costs to generate such information and the benefit the information would presumably provide to users. We believe that IFRS 7, *Financial Instrument Disclosure*, provides a framework that balances the disclosure of decision useful information and associated costs of implementation.

IFRS 7 requires disclosure about liquidity risk and interest rate risk consistent with the requirements in the ED. However, the underlying principle of IFRS 7 is that the disclosures should be based on the information provided internally to key management personnel. IFRS 7 prescribes what information should be disclosed (i.e. maturity analysis, sensitivity analysis, description of risks an entity is exposed to and how the entity manages the risks, etc) but not how the information should be disclosed (i.e. time intervals, expected maturities, repricing gap analysis, and changes in rates for sensitivity analysis) thereby allowing preparers more judgment and discretion to decide on the nature and the extent of disclosures needed for their specific circumstance. The consequence of this is that the information a preparer discloses

about these risks reflects the entity's own experience relative to the actual steps, processes and methods that the entity employs to manage these risks as part of its internal risk management policies. The company believes that disclosing information about these risks on the basis of the information provided internally to key management personnel would provide the financial statement users better insight about the entity's risk profile and how the entity manages these risks. The company also believes that providing disclosure on the basis of information already provided internally to key management would ease the implementation burden and costs that would otherwise be associated with generating new 'customized information'.

Additionally, the company notes that the IFRS 7 model has been tested in the U.S. financial reporting system as this has been the model applied by foreign private issuers since 2007. Therefore, an IFRS 7 model would not be new to U.S. users. In addition, an IFRS 7 disclosure model would provide an opportunity for further convergence between U.S. GAAP and IFRS consistent with the objective of the ongoing financial instrument convergence project. Also, while the company recognizes that the Board's disclosure framework project is in its early stages, the company believes that the IFRS 7 approach would be better aligned with the concepts underlying the Board's recently released discussion paper because it allows more judgment and discretion to preparers in disclosing relevant information that is specific to an entity's business.

The requirements to disclose information about liquidity and interest rate risk that comply with the proposed prescriptive model would undoubtedly give rise to the need to creating 'customized information' that a preparer would not typically generate in its day to day operations. The Company believes the consequence of creating a new set of data to comply with the proposed disclosure model would result in increased implementation burden and costs. As a result, the company urges the Board to consider a disclosure model similar to that provided under IFRS 7, *Financial Instrument Disclosure* which, we believe would largely accomplish the objectives of the proposed ASU while easing the implementation process.

3. Cash Flow Obligations Table

The cash flow obligations table (and the liquidity gap analysis for financial institutions) requires the use of expected maturity versus contractual maturity. While this may be more meaningful information, this will present several operational issues. This will require significant judgment in an effort to predict the actions of clients and other third-parties. This type of information is not readily available today and will require a significant effort to define and implement a process that ensures SOX compliance and auditability.

In addition, the cash flow obligations table is intended to present the expected financial cash flows of the entity on an undiscounted basis. The table in Example 6 of the ED displays derivatives as a single line item separately disclosed, without any adjustment to the carrying value. By excluding the adjustment to carrying value the example seems to indicate that the amount disclosed in the Cash Flow Obligations Table would be at carrying value (on a discounted basis). We believe that disclosing derivatives at carrying value would be appropriate, and recommend that clarity be added to the text of the standard.

In addition, paragraphs 825-10-50-23N and O require use of the time intervals required by paragraphs 825-10-50-23G and H for annual and interim periods, respectively. There are certain classes of liabilities (i.e. those recorded in accordance with Accounting Standards Codification 450 Contingencies) that maybe difficult to estimate for the quarterly intervals

defined.

Overall, we feel that the time interval requirements in the ED are far greater than what is required and will present a significant burden to preparers. The financial statements present a view of current assets and liabilities. We do not believe a further breakdown by quarter is required for current items.

4. Available Liquid Funds

Paragraph 825-10-50-23U states, "…an entity shall include a narrative discussion about the effect of regulatory, tax, legal, repatriation and other conditions that could limit the transferability of funds among entities. This disclosure shall include quantitative amounts related to funds subject to those conditions, if applicable."

We believe the required disclosure of encumbered cash may be misleading. In many cases, an entity intends to use overseas cash to fund operations and transactions in those jurisdictions. Disclosing encumbrances on cash could lead users to believe that the cost being disclosed is an unavoidable cost associated with the asset, however, in many cases the entity plans to use the cash in its operations within the jurisdiction. It is unclear why calculating and disclosing a cost that is not likely of occurring provides decision useful information. We believe this requirement should be removed.

5. MD&A and Liquidity

As discussed above, we have a concern with presenting an additional set of disclosures in the financial statements . While the ED acknowledges the overlap with the current liquidity disclosures, it ignores that the proposed disclosures under the ED may be confusing if there is no reconciliation to the information in MD&A. As an example, the currently required MD&A information contains data that is based on contractual maturities, while the ED would require expected maturities. We believe a single, integrated discussion of an entity's liquidity and interest rate risk would lessen confusion and be more useful to readers of the financial statements.

6. Timing

While the ED does not provide a time frame, we believe that there should be appropriate lead time prior to adoption. We have identified the following items that would require additional system/process enhancements within our infrastructure.

- The time intervals required by the ED would require systems enhancements. For example, we currently segregate accounts payable between those obligations due in less than one year and longer term payables, consistent with the financial statement presentation. Our systems currently do not segregate payables on a quarterly basis. Also, significant manual data gathering will be required when evaluating expected maturities for the liquidity gap maturity analysis, and when collecting information from smaller countries in which we do business.
- We also anticipate the need for sufficient lead time to create appropriate controls around the data that was previously unaudited. We would also suggest that the timing of the ED should take into account the need to have the controls operational for some time

before the ED is made effective. We would like to note that IFRS preparers had approximately three years to implement IFRS 7. .

These concerns are magnified when considering the requirement to provide this information on an interim basis.

Thank you for the opportunity to comment on this proposal. If you have any questions or wish to discuss any topic further, please do not hesitate to contact me at 914-766-2008.

Gregg L. Nelson

VP, Acctg. Policy & Financial Reporting

IBM Corporation

3D-10, Bldg 2

294 Route 100, Somers, NY 10589

914-766-2008 Office

914-438-4855 Cell

gln@us.ibm.com