Technical Director -- File Reference No. 2011-175
Financial Accounting Standards Board
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VIA EMAIL: director@FASB.org

File Reference: Comments on Discussion Paper, Selected Issues about Hedge Accounting

Ford Motor Company ("Ford") a global automotive industry leader based in Dearborn, Michigan, manufactures or distributes automobiles across six continents. Ford Motor Credit Company LLC ("Ford Credit") is an indirect, wholly owned subsidiary of Ford that provides dealer and customer financing to support the sale of Ford Motor Company products.

We appreciate the opportunity to comment on the Discussion Paper, "Selected Issues about Hedge Accounting." We fully support the goal of both Boards to reduce the complexity of hedge accounting and more closely align the accounting for derivatives with risk management practices. Specifically we:

- Appreciate the efforts of both Boards to simplify the effectiveness testing requirements
- Encourage the Boards to clarify what is meant by "risk management" for purposes of this guidance
- Support the proposal that allows entities to apply designated hedge accounting to the change in cash flows or fair value of an item attributable to a specific risk, provided the component is separately identifiable and reliably measurable
- Encourage the Boards to reconsider allowing voluntary de-designation for purposes of rebalancing a hedging portfolio
- Disagree with certain requirements to disclose predictive information that we believe most entities would believe is sensitive and competitive in nature

We have responded to certain questions addressed in the Discussion Paper in our Attachment. We appreciate the Boards' consideration of these matters.

Sincerely,

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Attachment
Ford Motor Company

Responses to Specific Questions for Comment

Risk Management

The IASB’s proposed guidance would rely substantially on an entity’s risk management objectives as a basis for hedge accounting. Paragraph 1 of the IASB’s Exposure Draft states that “The objective of hedge accounting is to represent in the financial statements the effect of an entity’s risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss.”

Question 1: When an entity uses financial instruments to manage risk exposures in economic hedges but those instruments are not designated in hedging relationships for accounting purposes, do you believe that the proposed guidance would provide useful information about all of the effects of an entity’s risk management objectives?

We support the proposed objective to align hedge accounting principles with an entity’s risk management objectives. We strongly believe that the financial statements should reflect the economics of our hedging activities. Present hedge accounting rules under ASC 815 limit our ability to designate all of our derivatives despite the fact that they are economically effective hedges and are consistent with sound risk management activities. We view the proposed guidance as a means of aligning our financial statement reporting with our risk management objectives that will ultimately improve the usefulness of our financial statements for users.

Question 2: Do you believe that the proposed guidance and illustrative examples included in the IASB’s Exposure Draft are sufficient to understand what is meant by risk management, how to apply that notion to determine accounting at a transaction level, and how to determine the appropriate level of documentation required? Why or why not?

We find the proposed guidance related to the use of the term “risk management” confusing. We believe the Boards should clarify the use of the term, including whether or not its meaning is the same in all contexts. For example, we are exposed to a variety of market and other corporate risks. Our risk management objectives and the strategies we use to achieve our objectives are developed from a corporate, or enterprise viewpoint. We implement the risk management strategies at the individual transaction level. It is confusing whether the guidance related to documentation, effectiveness testing, rebalancing, etc., should be performed at the enterprise level or the transactional level.

We urge the Boards to clarify that the hedge accounting principles applied should be based on an entity’s economic risk management objectives and strategies. Furthermore, we urge the Boards to clarify that the eligible hedged item, the hedging instrument, assessment of effectiveness, the need for rebalancing, etc., should be documented and evaluated at the transactional level. It is our view that without this additional clarity, a misalignment of views between an entity and its auditors may occur.

Question 4: Do you foresee any significant auditing issues arising from the proposed articulation of risk management and its link to hedge accounting? For example, is the information required to be disclosed regarding an entity’s risk management strategies measurable and objective? Could the inclusion of an entity’s risk management objectives create an expectation gap that the auditor is implicitly opining on the adequacy of an entity’s risk management objectives?
We believe hedge accounting should be reflective of the company’s risk management objective, and in that sense, linked to the economic hedging of risk. We also believe that the articulation of an entity’s risk management objective should be consistent with the objective approved through its corporate authorities and controls process. However, risk management is much broader than hedge accounting. It is not always measurable and objective. For some risks, management decides to mitigate the exposure by executing hedging strategies; for some risks, management decides to remain unhedged and exposed; and for some risks, management identifies natural offsets to the exposure.

An entity’s risk management objectives and strategies to mitigate risks should not be the focus of the audit; auditors should focus their assessment on whether the entity under review has complied with the accounting guidance. Auditors should not opine on the adequacy of risk management objectives; to do so would be to thwart the responsibility of corporate management.

We believe that if the Boards require quantitative disclosures as proposed in paragraphs 40-48, there will be an implicit expectation that the auditor should opine on the adequacy of the risk management objective. Therefore, we strongly urge the Boards to clarify the definition of “risk management,” clarify their expectations for documentation, and require only a qualitative discussion of the entity’s risk management strategies specific to the above referenced paragraphs. We view this as critical in order to avoid the expectation gap between preparers and their auditors during the audit, and to avoid a potential gap in the user’s expectation of the auditor’s opinion.

Hedged Items—Risk Components

The IASB’s proposed guidance would specify that a portion (referred to as a “component”) of an item can be designated as a hedged risk if it is separately identifiable and reliably measurable. Examples in the IASB’s Exposure Draft illustrate that a hedged item could be a component that is not contractually specified or a component that is inferred.

Question 7: 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 welcome the proposed guidance that enables an entity to designate the risk components of an item as a hedged item if the risk components are separately identifiable and reliably measurable. This provision is particularly important to Ford. We are exposed to price risk for raw materials consumed in the manufacture of parts we purchase from our suppliers. For example, we will often negotiate with a supplier who will provide us with parts throughout a production period. The price for the part consists of a raw material component that varies over time based on changes of a related published index, as well as a labor and overhead component, which is fixed. In some cases, we economically hedge the price risk associated solely with the changes in price of the raw material by purchasing financial derivatives. We are unable to designate the derivatives under the accounting rules of ASC 815 because the derivatives do not hedge the entire cash flow (both the fixed and variable element) of the forecasted part purchase.

We view the prohibition against designating a risk component of a non-financial instrument (e.g., the change in price of raw material in a supply arrangement) in ASC 815 to be arbitrary and conceptually inconsistent in principle with the ASC 815 approval for designing a risk component of a financial instrument (e.g., the change in benchmark interest rate risk). We believe that providing the option to designate a risk component related to a forecasted future transaction as a hedged item is a logical step in the alignment of an entity’s risk management strategy, the economic outcome of the strategy and the related accounting. We also believe the option to designate a risk component in a hedging relationship provides more useful information to the users of our financial statements as the economically effective portion of the hedging relationship will no longer be labeled as “ineffectiveness.”
Question 8: Do you believe that “separately identifiable” should be limited to risk components that are contractually specified? Why or why not?

We recommend the Boards provide additional guidance for the term “separately identifiable” for risk components that are implicitly included in certain arrangements. The Boards might consider whether a risk component would meet the “separately identifiable” criterion if an entity could document the implicit risk component in terms of a percentage of the content of a hedged item.

Changes to a Hedging Relationship

The IASB’s Exposure Draft would permit and sometimes require an entity to “rebalance” an existing hedging relationship and continue to account for the revised hedging relationship as an accounting hedge. However, when there is a change in the entity’s risk management objective for a hedging relationship or a hedge ceases to meet the qualifying criteria, the IASB’s Exposure Draft would require the entity to discontinue hedge accounting.

Question 16: Do you foresee any significant operational concerns or constraints in determining whether (a) a change to a hedging relationship represents a rebalancing versus a discontinuation of the hedging relationship or (b) an entity’s risk management objective has changed? If yes, what concerns or constraints do you foresee and how would you alleviate them?

We recommend that the Boards permit, but not require an entity to rebalance its hedge relationships. We believe that if an entity’s risk management strategy includes determining an “optimal” hedging ratio, for example in certain dynamic hedging strategies, permitting an entity to rebalance would most closely align the accounting for hedge relationships with an entity’s risk management strategy. However, not all risk management strategies are designed to implement an “optimal” hedging ratio. In some cases, the risk management strategy may be quite simple and straightforward. Compulsory rebalancing would contradict the alignment of hedge accounting with the entity’s risk management strategy, would likely result in incremental costs, and in some cases, produce an accounting exercise for the sake of financial reporting only.

Furthermore, we recommend that the Boards reconsider the guidance included in their respective exposure drafts that would prohibit voluntary de-designation of a hedging relationship. We view permitting an entity to de-designate voluntarily a hedging relationship to be a reasonable means for rebalancing a relationship. This is particularly the case when there is a newly identified exposure that will naturally offset an existing hedged exposure. If an entity is required to maintain an “optimal” hedging ratio even after a new and off-setting exposure is identified, the entity will likely incur real economic transaction costs that could otherwise be avoided by voluntary de-designation. Therefore, we urge the Boards to provide the option to rebalance, or to de-designate voluntarily, consistent with the facts and circumstances and risk management strategy of the entity.

Disclosures

The Exposure Draft would require disclosures about the risks that an entity decides to hedge and for which hedge accounting is applied.

Question 22: Do you foresee any significant auditing issues arising from the inclusion of risk management disclosures in the notes to the financial statements? If yes, what issues do you foresee and how would you alleviate them? Do you believe that it is appropriate to include risk management disclosures in the notes to the financial statements rather than in other information in documents containing financial statements? Why or why not?
We support the IASB's proposal to present financial information about risk management activities in the footnotes while allowing for cross-reference to information already provided in the management discussion or risk analysis sections provided with the financial statements. We also support the Boards' intent to allow entities flexibility in determining the appropriate level of disaggregation and the amount of detail to provide.

However, we believe that the Boards' request for quantitative information, specifically in paragraphs 40(b) and 45-48, is extensive and intrusive. We strongly urge that the desired information be required in qualitative terms only, and only in the context of a discussion of the overall risk management strategy. Quantitative disclosures regarding the extent to which each type of risk is hedged, the monetary amount or quantity to which an entity is exposed for each type of particular risk, and how a company's hedging activity may affect the amount, timing and uncertainty of its future cash flows are highly sensitive information and are often considered competitive in nature.

Paragraph 46 requires disclosure of information for each future period that a hedging relationship is expected to affect profit or loss. The information that an entity would disclose is subjective and extrapolative and we question the validity of providing such information. Given its subjective nature, the information could be another source of misalignment between preparers and their auditors who might have a different subjective conclusion.