



**THE PEPSI BOTTLING GROUP**

THOMAS M. LARDIERI  
VICE PRESIDENT AND CONTROLLER



August 15, 2008

LETTER OF COMMENT NO. 69

Mr. Russell G. Golden  
Director of Technical Application and Implementations Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

***Subject: File Reference No. 1590-100  
Proposed Statement of Financial Accounting Standards, "Accounting for Hedging  
Activities an amendment of FASB Statement No. 133"***

Dear Mr. Golden and Board Members:

The Pepsi Bottling Group, Inc. appreciates the opportunity to comment on the proposed Statement of Financial Accounting Standards, "Accounting for Hedging Activities an amendment of FASB Statement No. 133." We support the FASB's efforts to establish and improve standards of financial accounting for the guidance and education of the public and, to that end, we are providing our comments.

*Component Hedging*

We do not believe eliminating (with exceptions) the bifurcation-by-risk model ("component hedging") improves financial reporting. In fact, we believe the use of component hedging should be expanded to include commodity hedging under certain circumstances. There are many factors that could affect the fair value of a hedged item, and a prudent risk management strategy attempts to minimize the volatility of those risks that can readily be hedged. As noted in the alternative views, derivatives are generally designed to manage discrete risks. If component hedging were prohibited, comparing the hedged risk to the overall risk in the assessment of effectiveness and in the measurement of ineffectiveness would exaggerate ineffectiveness from components of the hedged item that were not intended to be hedged, and drive volatility in a company's statement of operations. At best, the mismatch would increase income statement volatility; at worst, it would prohibit hedge accounting altogether. We do not believe the proposal to change the effectiveness threshold from highly effective to reasonably effective will mitigate this concern.

Forcing companies to compare economically dissimilar items for purposes of the effectiveness assessment will reduce the availability of prudent hedging strategies and may drive companies to enter into hedging strategies that stretch beyond their current risk management and economic objectives. Also, even if companies are able to achieve hedge accounting on the overall hedged item (whether it be a company's own debt, or costs of a non-financial asset purchased), they will be forced to estimate hypothetical fair

values of non-market-based cost elements of the hedged item. In certain situations, there is no robust, reliable fair value model to value such non-market-based costs. Without a reliable fair value measurement model, inconsistencies in measurement models will drive non-comparable reporting of similar items within an industry, thus eroding the quality of financial reporting.

As noted above, we believe the use of component hedging should be expanded to allow component hedging of commodity risks under certain circumstances. As part of a prudent risk management strategy, businesses regularly hedge commodity risks that can be managed to eliminate economic volatility and to provide predictability in the reporting of a company's operating costs. We believe component hedging should be allowed to hedge the risk of changes in the price of commodities when the commodity component of an item can be discretely identified and measured, and the amount purchased (and hedged) is consistent with the production requirements of a business. There are many procurement contracts based on a "cost plus" formula where some cost is indexed to an exchange traded commodity. For these contracts, the hedgeable commodity portion of the item being purchased can be discretely identified and measured. In these circumstances we believe component hedging is appropriate because it allows companies to manage the risk of change in a significant component of the cost of the purchased item without introducing financial statement volatility related to unhedgeable costs (such as delivery, conversion and taxes). If concerns exist about overhedging as a means of commodity speculation, we would suggest component hedging for commodities be allowed only to the extent of the business requirements for the commodity.

#### *Operational Issues*

We believe the main principle of the proposed hedge effectiveness requirements poses serious operational concerns. Paragraph 6 of the proposed Statement states:

At inception of a hedging relationship, an entity shall qualitatively assess that relationship's effectiveness. The qualitative assessment shall demonstrate the following:

- a. An economic relationship exists between the hedging instrument and the hedged item or hedged forecasted transaction.
- b. Changes in fair value of the hedging instrument would be reasonably effective in offsetting changes in the hedged item's fair value or the variability in the hedged cash flows.

*In certain situations, a quantitative assessment may be necessary at the inception of a hedging relationship to conclude that changes in fair value of the hedging instrument would be reasonably effective in offsetting changes in fair value of the hedged item or variability in cash flows of the hedged transaction.*

A qualitative assessment can do nothing more than describe the qualities of the hedging instrument and the hedged item or cash flows. It can be used to make general observations about the behavior of a given financial instrument and about the hedged

item. Moreover, we do not believe auditors will accept general statements about the qualities of these items as proof of effectiveness in offsetting changes in cash flows or fair value. We suspect that the "certain situations" requiring a quantitative assessment will quickly be interpreted as situations in which an entity wishes to apply hedge accounting.

Even if auditors could be made comfortable with the notion of a qualitative assessment, comparing the many risks inherent in hedged items to the single risk addressed by a typical derivative instrument would likely lead to the conclusion that hedge accounting is prohibited, unless component hedging is retained or expanded beyond what is currently permitted.

Another aspect of the proposed Statement that will raise operational issues is the fact that the term "reasonably effective" has not been defined. If the FASB does not provide guidance on this term someone else will. We are concerned that without appropriate guidance, this will lead to a patchwork of audit firm and SEC staff interpretations that will become another minefield companies will be forced to traverse in order to apply hedge accounting. This organic approach relying on various sources of interpretive guidance usually results in inconsistencies in practice that can not be justified by any known accounting principle.

We understand the Board's hesitancy in defining terms such as "reasonable." After all, one of the most persistent complaints about Statement 133 is that it is a "rules-based" standard. However, until a comprehensive reconsideration of the hedge accounting model is completed it will remain a rules-based standard. The proposed Statement will not change that fact. If bright lines will be developed (and they will), we would prefer they be consistent and subjected to appropriate due process.

#### *Convergence and Control Issues*

For years now, the FASB and the IASB have been working under a memorandum of understanding to converge U.S. GAAP and IFRS. The Boards agreed that in divergent areas they would review both the FASB and IASB guidance and either choose to converge to the superior solution (if the guidance within one regime were clearly superior) or to work together to find a common solution that both Boards would adopt. In March, the IASB issued a Discussion Paper, *Reducing Complexity in Reporting Financial Instruments*. The IASB issued the discussion paper as the basis for future discussions, ultimately leading to the reconsideration of existing standards on financial instrument measurement and hedge accounting. The proposed Statement presupposes a conclusion among the alternatives discussed in the IASB's discussion paper. Also, talk of adopting IFRS has become much more urgent as of late, with speculation that U.S. companies could be required to adopt IFRS within a few years. Potentially, we could be put into the position of having to adopt the proposed Statement, then, very soon thereafter, adopt IAS 39, and then whatever subsequent accounting standard that would be promulgated following the exploration of issues in the discussion paper.

We believe in the spirit of the memorandum of understanding, the FASB and the IASB should come to a mutually agreed conclusion on the appropriate accounting for hedging

activities. The converged treatment could then be adopted consistently on a worldwide basis. Forcing companies to change processes and systems knowing they will have to be again changed upon convergence to IFRS is costly, ineffective, and not productive to the progress of the convergence project. In addition, we believe numerous changes to accounting methods over a short period of time creates control issues and undermines consistency in financial reporting.

### *Conclusion*

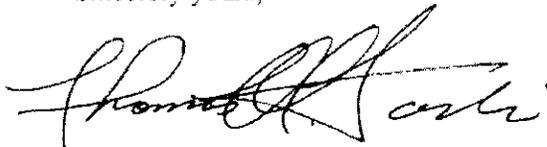
The Pepsi Bottling Group, Inc. supports the Board's efforts to simplify the hedge accounting model, however, we do not believe the proposed Statement, as currently written, would achieve that objective. We believe prohibiting component hedging will limit risk management strategies available to companies without providing the intended improvements to financial reporting. Further, we would recommend expanding the use of component hedging to commodities in circumstances where the hedgeable commodity portion of a product can be discretely identified and measured, and the hedged amount is consistent with an entity's business requirements.

If the SEC requires IFRS reporting in the near future, we believe the cost of implementing a very short-lived standard will be wasted, and the exercise will be a control risk in and of itself.

If the Board decides to adopt the "reasonably effective" threshold, we believe the term "reasonably effective" should be defined to make the standard operational.

We hope you find our comments helpful in improving financial reporting.

Sincerely yours,



Thomas M. Lardieri