From:	Gregg Nelson
To:	Director - FASB
Subject:	Selected Issues about Hedge Accounting, File Reference No. 2011-175
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April 25, 2011
Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856

Re: File Reference No. 2011-175 – Selected Issues about Hedge Accounting (Topic 815)

Dear Ms. Cosper:

International Business Machines Corporation ("IBM" or "the company") appreciates the opportunity to comment on the Discussion Paper, Selected Issues about Hedge Accounting ("discussion paper"). Please note that we have previously submitted a comment letter on the International Accounting Standards Board (the "IASB") exposure draft on hedge accounting.

Overall, we support the IASB's willingness to move further than the Financial Accounting Standards Board (the "FASB") in reducing the complexity associated with the current hedge accounting model, in expanding the eligibility regarding what items can qualify for hedge accounting and in what instruments can be designated. Therefore, it is our view that the hedging model proposed by the IASB provides a better starting point. However, we do disagree with certain aspects of the IASB exposure draft, including the introduction of the re-balancing requirement, the prohibition of voluntary de-designation and the change in presentation for fair value hedges.

Further, as indicated in our response to the IASB exposure draft, we are disappointed with the lack of convergence. We believe it is imperative that the FASB and IASB focus on developing a single converged financial reporting model for hedging with uniform effective dates.

Following are our responses to the specific questions included in the discussion paper.

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?

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 support a closer alignment of hedge accounting to an entity's risk management activities as this will provide users with more useful information. We believe the scope of the disclosure requirements within this standard should be limited to those risk management objectives which management chooses to mitigate through the use of derivative financial instruments (see also answer to Question 22 on disclosure requirements). However, we do not believe it is practicable to apply risk management objectives on a hedge by hedge basis. Generally, entities consider risk management at a macro or portfolio level. If you require risk management to be defined on a transactional level, the accounting requirements end up directing the risk management strategies, which cannot be the intent of the guidance. Further, in line with this objective and with the Boards' joint project on the Statement of Comprehensive Income, we believe that hedge accounting should not distinguish between income statement and other comprehensive income as one of the hedging criteria, i.e. hedging should be available whether the risk exposure has an impact on earnings or on other comprehensive income. This would further support the view that the income statement should be used in combination with other comprehensive income, whether in one single statement or in two consecutive statements.

Question 3: Do you foresee an entity changing how it determines, documents, and oversees its risk management objectives as a result of this proposed guidance? If yes, what changes do you foresee? Do you foresee any significant difficulties that an entity would likely encounter in establishing the controls related to complying with the proposed guidance?

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?

Our view is that the required risk management procedures, documentation and disclosures under the new IASB guidance would not change our existing risk management procedures. We believe that current disclosure requirements for financial statements and other information in documents containing financial statements would meet the requirements under the new proposal (see exception under Question 22). Therefore, we do not believe that the IASB proposed guidance will result in any changes in an entity's risk management objectives or significant auditing issues.

Question 5: Should cash instruments be eligible to be designated as hedging instruments? Why or why not? If yes, is there sufficient rigor to prevent an entity from circumventing the classification and measurement guidance in other relevant accounting guidance (for example, IFRS 9, Financial Instruments, and IAS 21, The Effects of Changes in Foreign Exchange Rates)? Are there any operational concerns about designating cash instruments (such as items within a portfolio of receivables) as hedging instruments?

In our view, an entity should be able to use cash instruments to hedge its exposures. Since the entity's risk management procedures and requirements have to be met in order to be able to hedge, there should be sufficient rigor to avoid potential abuse of accounting rules.

Question 6: Do you believe that the proposed guidance is sufficient to understand what constraints apply when determining whether an item in its entirety or a component thereof is eligible to be designated as a hedged item (for example, equity instruments measured at fair value through profit or loss, standalone derivatives, hybrid instruments, and components of instruments measured at fair value through profit or loss that are not permitted to be bifurcated)? If not, what additional guidance should be provided?

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.

Question 8: Do you believe that "separately identifiable" should be limited to risk components that are contractually specified? Why or why not?

While we agree with less restrictive guidance on hedged items, we believe that more guidance is needed to understand the limitations of component hedging in addition to the criteria of "separately identifiable" and "reliably measurable". We believe that the guidance for non-contractually specified risk components should be clarified.

Although contractual specification will certainly make a component separately identifiable and reliably measurable, we believe that a restriction to contractually specified components would limit a company's ability to hedge components that may be separately identifiable and reliably measurable although not specifically identified in a contract.

Question 10: Do you believe that the proposed guidance is sufficient to understand what constraints apply to determining a layer component from a defined, but open, population? (For example, do you believe that the sale of the last 10,000 widgets sold during a specified period could be designated a layer component in a cash flow hedge?) If not, what additional guidance should be provided?

It is our understanding that based on the examples under B21 in the IASB exposure draft the above example would not qualify because the hedged item is not separately identifiable. The example would have to specify the sale of the first/next 10,000 widgets after April 1, 2011.

Overall, we support the IASB approach on extending eligibility regarding what items can qualify as a hedged item. Specifically we support the eligibility of components for both financial and non financial items.

Question 11: Do you foresee any operational concerns applying other guidance in IFRS (for example, guidance on impairment, income recognition, or derecognition) to those aggregated positions being hedged? For example, do you foresee any operational concerns arising when an impairment of individual items within a group being hedged occurs? If yes, what concerns do you foresee and how would you alleviate them?

We do not see the impairment of individual items within a group being hedged as an issue. In our view, this issue is very similar to macro hedging where constant shifting of exposure is necessary due to the dynamics in the hedged item. We would like to review the new guidance in the IASB exposure draft on macro hedging before commenting on the operational concerns of applying the guidance.

Question 12: Do you believe that the proposed guidance on aggregated exposures will provide more transparent and consistent information about an entity's use of derivatives? Why or why not?

We believe that derivatives that are part of the aggregated exposure should be accounted for the same as the hedged item and the actual hedging instrument as it is part of the hedging relationship. Thus, it should be part of the accounting offset, whether in earnings or in other comprehensive income. That being said, we disagree with the proposed change in presentation for fair value hedges as further discussed below.

Question 13: Do you believe that an entity should be permitted to apply hedge accounting to a group of cash instruments or portions thereof that offset and qualify as a group under the proposed guidance and satisfy the proposed hedge effectiveness criteria? Why or why not?

In our view, an entity should be able to use cash instruments to hedge its exposures. Since the entity's risk management procedures and requirements have to be met in order to be able to hedge, there should be sufficient rigor to avoid potential abuse of accounting rules.

Question 14: Do you foresee any significant operational concerns, including auditing issues, in determining how to assess whether a hedge achieves other-than-accidental offset? If yes, what concerns do you foresee and how would you alleviate them?

Question 15: Do you believe that the proposed guidance and illustrative examples are sufficient to understand how to analyze hedge effectiveness (for example, how to measure the change in the value of the hedged item attributable to the related hedged risk for nonfinancial items)? If not, what additional guidance is needed?

In view of the difficulties experienced by preparers in applying hedge accounting, we support the IASB's efforts to simplify accounting for hedging activities, including the effectiveness testing requirements. However, we believe that the proposed changes will create interpretive issues with the elimination of the bright line test of 80-125 percent, without specific guidance on when a quantitative assessment would be required. The current definitions of unbiased and other-than-accidental offset are unclear and may be interpreted differently by preparers. Without additional guidance, there may be an implicit requirement for preparers to perform quantitative assessments to avoid "second guess" risk or to prove the qualitative assertions. We believe the final standard should explicitly remove the quantitative analysis from the determination of hedge effectiveness. A qualitative-only approach will be more effective in determining effectiveness by applying a company's existing risk management procedures and further simplifying the hedge accounting model. We believe that our current corporate governance and risk management procedures would suffice to qualitatively ensure that our hedging programs are reasonably effective.

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?

Question 17: Do you foresee any significant operational concerns or constraints relating to the potential need to rebalance the hedging relationship to continue to qualify for hedge accounting? If yes, what concerns or constraints do you foresee and how would you alleviate them?

It is our understanding that the Board introduced the concept of the re-balancing requirement to avoid the potential abuse by companies through deliberate under-hedging of a cash flow transaction. We believe that the FASB approach of requiring the recognition of ineffectiveness for both under- and overhedges in cash flow hedge relationships meets the same goal without requiring another complex analysis. In our view, the goal of simplification and transparency is not achieved if the effectiveness assessments are replaced by re-balancing analyses that may prove to result in far more complex assessments and accounting treatment.
Further, we do not view the ability to de-designate hedging relationships to be problematic or an area of abuse under the current model. Hedge accounting by its nature is elective and, therefore, the ability to discontinue it is consistent with this notion. The objective of dynamic hedging strategies is to promote effective risk management by ensuring the hedging relationship contemplates the changing economic conditions of the hedged item.

Question 18: Do you believe that capitalizing the time value of an option as a basis adjustment of nonfinancial items (in other words, marking the asset or liability away from market) will improve the information that is provided in an entity's statement of financial position? Why or why not?

We are in favor of the proposed change in accounting for the time value of options as this approach is more in line with the economics of the hedging relationship and the overall risk management objective.

Question 19: Do you believe that the proposed presentation of the gains and losses in other comprehensive income will provide users of financial statements with more useful information? Why or why not?

We disagree with the proposed change in presentation for fair value hedges. While the presentation for derivatives in hedging relationships would be consistent for all three hedging relationship types under the proposed model, we believe that the presentation for derivatives should follow the basic model (i.e. fair value through earnings) unless a change in presentation is required, such as under cash flow hedges of forecasted transactions in order to ensure an offset in earnings at the time the transaction occurs. In our opinion, it will neither improve the usefulness of information for users nor simplify the existing requirements. In fact, it creates additional complexity with the required recycling of the fair value adjustments from other comprehensive income into earnings which would necessitate significant system changes.

Question 20: Do you believe that the proposed presentation of a separate line item in the statement of financial position would increase the transparency and the usefulness of the information about an entity's hedging activities? Why or why not?

Question 21: Do you believe that there is sufficient guidance to specifically link the hedging adjustments to the hedged assets and liabilities that compose a hedged net position with respect to presenting a separate line item in the statement of financial position?

In our opinion, the proposed presentation would confuse users of financial statements rather than provide additional transparency and result in an overly complex statement of financial position. While information about the fair value adjustment of the hedged item may be useful to users of financial statements since it provides the hedging effect, we believe that disclosing the hedge accounting adjustment in the notes to the financial statements is sufficient. This alternative presentation also avoids burdening the face of the financial statements with potentially immaterial amounts.

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 agree with most of the disclosure requirements introduced in the exposure draft as they represent a convergence between proposed IASB and the current FASB disclosure guidance on derivatives and hedging activities. In particular, we believe that current tabular disclosures under U.S. GAAP should suffice for disclosure purposes under the proposed IASB guidance. Further, current U.S. Securities and Exchange Commission ("SEC") reporting requirements provide for extensive disclosure of risk management focus areas and activities in other information in documents containing financial statements. It is our opinion that these disclosures should meet the current requirements if the respective derivatives footnote is referenced.

However, we disagree with the requirements in paragraph 46 to disclose a breakdown of the quantity of the exposure, the quantity hedged and the effects of hedging. As these requirements are only applicable to those entities that apply hedge accounting we believe that requiring information about amounts or quantities of exposures hedged discriminates against those that choose to apply hedge accounting. We do not see such information as being more or less useful on the basis of whether an entity chooses to apply hedge accounting. Also, the exposure draft would require an assessment of the probability of forecast transactions that are not hedged. This would be more judgmental bearing in mind the transactions that are hedged are considered the bottom layer of all forecast transactions and therefore are the ones that are more likely to occur. Disclosing the degree to which forecast transactions are hedged is no doubt of some value, but we question whether it will be practical, particularly over a long time period. Overall, we note the potential commercial sensitivity of these disclosures. In addition, requiring forecast information may be prohibited in some jurisdictions and create auditing issues given the subjective nature of forecast information.

Question 23: Do you believe that the changes proposed by the IASB provide a superior starting point for any changes to U.S. GAAP as it relates to derivatives and hedging activities? Why or why not? Should the FASB be making targeted changes to U.S. GAAP or moving toward converging its overall standards on derivatives and hedging activities with the IASB's standards?

In our view, the hedging model proposed by the IASB provides a superior starting point as the proposed changes are more pervasive and far reaching than the FASB proposed guidance. We support the IASB approach of aligning the accounting for hedging activities further with the company's economics and risk management objectives. That being said, we do disagree with certain of the proposed changes in the IASB exposure draft as discussed in above specific answers.

If you have any questions about our comments or wish to discuss any of the issues raised in this letter please contact Gregg Nelson at 914- 766-2008 or Joerne Schroedter-Albers at 914-766-2869.

Sincerely,

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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