



MBA's Accounting, Tax and Financial Analysis Conference 2007

FASB Update

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Carlsbad, CA

FAS 133

- Proposed DIG Issue E23
- Derivative Disclosures
- Accounting for Hedging Activities

Proposed DIG Issue E23

- Addresses implementation issues in applying the short-cut method
- Posted for comments in July 2007
- Currently in redeliberations

Proposed DIG Issue E23

- Trade date vs. Settlement date
 - Must designate on trade date for both the swap and the hedged item
- Notionals
 - Swap must match hedged item
 - Entire term for fair value hedge
 - Each hedged interest payment for cash flow hedge
 - Scheduled and unscheduled amortization is OK, so long as the swap notional matches the hedged item.
 - Fix and variable leg of the swap must match throughout the life of the swap
 - Zero-coupon hedges cannot qualify for short-cut

Proposed DIG Issue E23

- Swap has fair value of zero at inception
 - Transaction price vs. fair value under FAS 157

- 68(e)- the catch all category
 - Terms of swap are hedged item are both:
 - Typical; and
 - Do not invalidate the assumption of no ineffectiveness

 - Examples of issues:
 - Par value not equal to fair value at inception
 - OK if due to coupon rounding
 - Late hedging
 - not permitted in short-cut
 - point of contention in many comment letters
 - Zero coupon hedges
 - swap contains a financing element

Derivative Disclosures

- Objective- improve disclosures about derivatives
- Enhanced understanding of:
 - How and why an entity uses derivatives
 - How derivatives and related hedged items are accounted for
 - How derivatives affect the balance sheet, income statement, and cash flows
- Requires new qualitative and quantitative disclosures
- Proposed disclosures effective for both interim and annual periods

Derivative Disclosures

- Tables by individual risk (i.e., interest rate, credit, FX, overall price)
- Separate tables for derivatives with multiple underlying risks (i.e., interest rate and FX)
 - Disaggregate by designation (i.e., fair value hedges, cash flow hedges, net investment hedges, no hedge designation).
 - Open positions at period end
 - Assets
 - Liabilities
 - ➔ Notionals
 - ➔ Where recorded on the financial statements
 - ➔ Amount recognized in earnings
 - Closed positions
 - Where recorded on the income statement
 - Amount recognized in earnings

Derivative Disclosures

- Tabular disclosures no longer require linkage between the balance sheet and the income statement.
- Board still considering:
 - Whether hedged item should be included in the tabular disclosures
 - Whether there should be an exception for trading activities
- Future discussions:
 - Contingent features
 - Notional amounts
 - Leverage factors
 - Frequency of disclosure
 - Effective date

Accounting for Hedging Activities

- Objective:
 - Resolve practice issues
 - Simplify hedge accounting
 - Make financial reporting of hedging activities easier to understand
- Establishes new criteria for hedge accounting:
 - Proposes to eliminate many requirements of FAS 133 hedge accounting, such as:
 - Bifurcation by risk
 - Shortcut method
 - Critical terms match
 - Requirements to quantitatively assess hedge effectiveness

Accounting for Hedging Activities

- Retains fair value and cash flow hedging
 - Net investment hedging as not yet been addressed
- Criteria for hedge accounting simplified
 - Identify hedging instrument
 - Identify hedged item
 - Qualitative effectiveness evaluation
 - A business purpose exists for relationship
 - Derivative should be expected to reasonably offset changes in fair value of the hedged item
 - Quantitative assessment may be required if circumstances indicate the relationship is no longer effective
 - Derivative does not have to be highly effective at offsetting changes in fair value of the hedged item
 - Reasonably effective threshold established to qualify for hedge accounting

Accounting for Hedging Activities

- Reassess effectiveness if circumstances indicate the hedging relationship is no longer effective
 - Dependent upon the nature of the hedging instruments and the hedged transactions
- Fair Value Hedges
 - Late hedging permitted
 - Revocability
 - Can de-designate and re-designate relationships
 - Changes in fair value of the hedged item during the period recognized in earnings

Accounting for Hedging Activities

- Fair Value Hedges – Issuer's Own Debt
 - Can designate a hedge of the benchmark interest rate, rather than entire change in fair value
 - Issuer's own credit risk excluded from the change in fair value
 - Designation must be on the trade date of the debt to qualify for benchmark rate hedging, otherwise the full change in fair value must be hedged

Accounting for Hedging Activities

- Cash Flow Hedges
 - Applicable to:
 - Existing assets and liabilities
 - Forecasted proceeds or interest payments from debt to be issued
 - Forecasted purchases and sales of non-financial assets
 - All risks hedged
 - Similar to Fair Value hedges, exception for hedging issuer's own debt
 - Can hedge benchmark interest rate if designated on the trade date
 - Ineffectiveness
 - Measured based on comparison of the actual derivative to the hypothetically perfect derivative (perfect for all hedged risks)
 - Recognized for both over and under hedges

Questions?

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