



Investors Technical Advisory Committee

401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116 | Phone: 203 956-5311 Fax: 203 849-9714

Via Email

September 17, 2008

Robert H. Herz
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT 06856-5116

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Re: Invitation to Comment -- Reducing Complexity in Reporting Financial Instruments

Dear Chairman Herz and Chairman Tweedie:

The Investors Technical Advisory Committee (ITAC) appreciates the opportunity to provide its views on the March 28, 2008 Invitation to Comment, *Reducing Complexity in Reporting Financial Instruments*.¹

In the past, both the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively the Boards) have expressed their support for fair value measurement of all financial instruments. As indicated in several comment letters previously submitted to both Boards, ITAC also supports the goal of achieving full fair value measurement for financial instruments.²

We believe that investors would benefit greatly, and financial reporting in general would be substantially improved, if a single and consistent measurement-basis were to be used

¹ This letter represents the views of the Investors Technical Advisory Committee (ITAC) and does not necessarily represent the views of its individual members, the organizations in which they are employed, or the views of the Financial Accounting Standards Board (FASB) or its staff. For more information about the ITAC, including a list of the current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee/.

² Letter from Rebecca McEnally, Member, ITAC, to Mr. Robert Herz, Chairman, FASB & Sir David Tweedie, Chairman, IASB (May 23, 2008), http://www.fasb.org/investors_technical_advisory_committee/itac_05-23-08.pdf;
Letter from Elizabeth F. Mooney, Member, ITAC, to Mr. Robert Herz, Chairman, FASB (July 25, 2008), <http://www.fasb.org/oc/1590-100/52268.pdf> [hereinafter *Mooney*] (see Attachment).

for all financial instruments. We also concur with the Boards' view that this measurement method should be fair value and **believe the Boards should require fair value as the only measurement method for financial instruments**. We hold this view for several reasons.

First, and most importantly, fair value measures reflect the most current, complete and accurate estimates of the value of financial instruments, and are based upon an up-to-date assessment of the amounts, timing, and riskiness of the future cash flows attributable to the asset or obligation. As market conditions change, the values, risk profiles and prospective cash flows of financial instruments change as well. It is essential that investors, who provide capital to companies and bear risk as a result, have a clear understanding of the effects of these changes.

Second, the current global financial crisis, accompanied by the meltdowns of a number of major financial institutions, organizations whose collapses have threatened the stability of financial markets and national economies worldwide, has highlighted the widespread exposure to financial instruments and the need for timely, relevant information on the value of such securities and related risks. Such information is critical not only for individual financial decision-makers to make well-founded decisions, but for the market discipline essential for creating fair and orderly markets. It goes without saying that regulators cannot act in a timely and effective manner unless they have the information required to identify and evaluate risks and developing threats to the financial system.

Third, the myriad of measurement methods and options that proliferate in financial reports today³ as a result of the dozens of reporting standards for different types of financial instruments obscure the effects of a company's financial arrangements on its operations and make financial statement analysis a daunting task, even for the highly experienced and savvy financial statement user. As a result, the utility of financial statements is grossly undermined for investors who rely on the information impounded in the statements in making informed investment and credit decisions.

Fourth, the current mixed-attribute model is not only confusing for users but it creates structuring opportunities to achieve a particular accounting effect as noted in a 2005 U.S. SEC report (Report).⁴ The Report states on page 4:

The Staff recommends the continued exploration of the feasibility of reporting all financial instruments at fair value. Supporters of greater use of fair values on the balance sheet argue that the most useful information is that

³ As clearly evident by the listing enumerated in Table 1 of the International Accounting Standards Board Discussion Paper, *Reducing Complexity in Reporting Financial Instruments* 14-15 (Mar. 2008), http://www.iasb.org/NR/rdonlyres/A2534626-8D62-4B42-BE12-E3D14C15AD29/0/DPReducingComplexity_ReportingFinancialInstruments.pdf [hereinafter *Discussion Paper*].

⁴ Staff of U.S. Securities & Exchange Commission, *Report and Recommendations Pursuant to Section 401(c) of the Sarbanes-Oxley Act of 2002 on Arrangements with Off-Balance Sheet Implications, Special Purpose Entities, and Transparency of Filings by Issuers* (June 15, 2005), <http://www.sec.gov/news/studies/soxoffbalancrpt.pdf>. [hereinafter *Report*]

*which reflects the current values of assets and obligations. Fair value accounting for all financial instruments also would appear to have benefits in terms of reduced complexity (for example, by eliminating the need for hedge accounting and its attendant documentation and effectiveness testing requirements, in many instances), more understandability, and less motivation to structure transactions so as to achieve certain accounting treatments.*⁵ [Emphasis added].

We concur with the views of the SEC Staff that an effective way to reduce this complexity is to accelerate the use of fair-value measurement for all financial instruments.

However, it is apparent that current disclosures surrounding fair value measurement have been inadequate. Investors must be able to ascertain how fair value measures were developed, and what the implications of these sources and methods are for their analyses. In this regard, we emphasize the necessity for the Boards to develop both a comprehensive disclosure framework and to revamp performance reporting; both would enable users to understand key performance drivers and to distinguish among realized and unrealized components of profit and loss.⁶ We believe that these are essential in any event.

We are aware of the Boards' project on financial performance and recognize that this Invitation for Comments scopes out this project. However, we reiterate our view that a fair value measurement basis must be complemented with a rethink of the income statement and performance reporting as well as the development of a comprehensive disclosure framework that would underpin the use of fair value measurement.

ITAC has expressed strong support for fair value in the past, and we take this opportunity to note that there has been substantial support voiced in recent years for a movement towards full fair value for financial instruments, as well as acknowledgment that such a movement would be feasible. Please see Appendix I for what we believe are a few relevant examples of such support.

⁵ The *Report* also notes on page 4 concerns that some have raised with fair value measurement for financial instruments but observes:

Of course, some have expressed significant concerns with requiring fair value accounting for all financial instruments, such as the potential manipulability and degree of difficulty in auditing some fair values. However, in light of the potential benefits, the Staff believes that methods should be sought to eliminate the obstacles to this treatment.

⁶ Letter from Mike Gyure & Marc Siegel, Members, ITAC, to Mr. Robert Herz, Chairman, FASB (December 11, 2007), http://www.fasb.org/investors_technical_advisory_committee/ITAC_Response_to_CIFiR_Subcommittee3.pdf.

The Invitation to Comment, while acknowledging that the long-term solution to reduce complexity in reporting for financial instruments is to use a single measurement attribute, fair value, seeks feedback on potential “intermediate” approaches that would not require all financial instruments be measured currently at fair value. While we believe that seeking “intermediate” approaches is unnecessary after more than two decades of public due process on these issues, we would support the IASB joining the FASB’s current efforts to simplify the accounting for hedging activities as contemplated by the FASB and further align IAS 39, *Financial Instruments: Recognition and Measurement* with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

More specifically, as indicated in our July 25, 2008 letter in response to the FASB Exposure Draft, *Accounting for Hedging Activities* (see Attachment),⁷ we would support the elimination of partial hedges under IAS 39 and Statement 133. We agree with the view expressed in the IASB Discussion Paper that this single change

*would reduce the complexity of hedge accounting for all parties. It would eliminate the number of rules that preparers and auditors have to deal with. It would also reduce the amounts of gains and losses that are temporarily recognized outside earnings, which would make financial statements easier for users to understand.*⁸

Upon completion of this project to eliminate partial hedging and simplify hedge accounting, we believe that the Boards should focus their joint efforts on moving as soon as possible to a full fair value framework for financial instruments in conjunction with completion of:

- The aforementioned financial statement presentation project;
- The development of a comprehensive disclosure framework; and
- A fair value measurement framework under IFRS.

In our view, the only substantial issues that the Boards need to resolve in order to effectuate a move to full fair value measurement for financial instruments relate to presentation and disclosure issues so that users are provided with the clearest, most complete and up-to-date information regarding fair values.⁹ We note that completion of these preconditions before a movement to full fair value for financial instruments would benefit several projects being addressed by both Boards, both now and in the future.

⁷ Mooney, *supra* note 2, at 2-3.

⁸ *Discussion Paper*, *supra* note 3, § 2.71, at 35. .

⁹ We believe the IASB should promptly adopt the fair value measurement framework of FASB Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (Sept. 2006), <http://www.fasb.org/pdf/fas157.pdf>.

We appreciate the opportunity to share with you our views on the Invitation to Comment on the topic of fair value measurement in general as well as specific issues. Should you have any questions or if you would like to discuss any of our comments in more detail, please contact Michael Moran at 212-357-3512 or michael.moran@gs.com.

Sincerely,

Investors Technical Advisory Committee

By:

A handwritten signature in black ink, appearing to read "Michael Moran". The signature is written in a cursive style with a horizontal line at the end.

Michael Moran
Member

cc: Kevin Stoklosa, Assistant Director of Technical Activities, FASB
Gavin Francis, Director of Capital Markets, IASB

Attachment

Appendix I – Examples of support for movement to fair value for financial instruments

- **CFA Institute’s October 2007 report *A Comprehensive Business Reporting Model*:** The Institute’s paper postulated that “fair value information is the only information relevant for financial decision making.” It expressed a concern that standard setters had not implemented a requirement to account for financial instruments, both assets and liabilities, at fair value and recommended that standard setters make it a priority. In addition, in a March 2008 survey, 79% of the Institute’s members that responded said that fair value measurement requirements for financial instruments will improve transparency and contribute to better investor understanding of the risk profiles of the companies. Moreover, 74% of respondents thought fair value requirements will improve market integrity in general.
- **SEC International Roundtable on Fair Value Accounting Standards, July 9, 2008:** Investors and other users of financial information expressed support for the importance of fair value measures at this public forum. One roundtable participant from a prominent investing firm stated “Investors are best served if all financial instruments are marked to fair value each period through profit and loss.” The participant further noted that “The present accounting for financial instruments, which uses a mixture of accumulated cost, fair value, amortized cost and lower of cost or market measurement attributes is a major cause of complexity for both users and preparers.”
- **SEC report on off-balance sheet arrangements:** The June 2005 report, conducted in accordance with the Sarbanes-Oxley Act of 2002 and referenced in the body of this letter, noted that “fair value accounting for all financial instruments would reduce the complexity of financial reporting.” The report further acknowledged that the existing mixed-attribute model, with a mix of historical cost and fair values presented on the balance sheet, had prompted a significant number of accounting-motivated transaction structures. Consequently, “the motivation for the transactions or the structuring could be essentially eliminated if all financial instruments were recorded at fair value.”
- **FASB/IASB *Update on the Status of the Memorandum of Understanding* memo:** This April 2008 report from a group of FASB and IASB staff and Board members indicated that when considering whether the Boards should press ahead with full fair value for all financial instruments, “there are no significant obstacles to doing so.” Rather, the memo noted that the remaining obstacles were related to presentation issues, as we addressed in the body of this letter, as well as political considerations.
- **Dissenting views on FASB Statement No. 159, *Fair Value Option for Financial Assets and Financial Liabilities*:** Two Board members dissented from the issuance of this standard. One of the dissenting members noted that the standard “reduces understandability” and “complexity and cost are shifted from the preparer to the user” as “the user will be required to expend more cost and effort to compare financial statements prepared using the fair value option with financial statements prepared

using a different measurement basis.” We note that subsequent to the issuance of FAS 159 many users have cited the optional nature of the standard as contributing to complexity.

- **Paper by NYU Professor Stephen G. Ryan, *Fair Value Accounting: Understanding the Issues Raised by the Credit Crunch*:** The July 2008 paper, commissioned by the Council of Institutional Investors, asks the question “whether fair value accounting provides more useful information to investors than alternative accounting approaches.” The paper explains why the answer to that question is “yes.”



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Via Email

July 25, 2008

Mr. Robert H. Herz
Chairman
Financial Accounting Standards Board
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Re: Proposed Amendment to FASB Statement No. 133 - Accounting for Hedging Activities

Dear Chairman Herz,

As you are aware, the ITAC strongly supports the FASB's objective to improve the quality, transparency, comparability and relevance of financial reporting and to reduce its complexity.¹ We are writing to provide views to both the FASB and the IASB on the issue of fair value measurement of financial instruments, and specifically to indicate ITAC's general support of the current proposal to amend Statement No. 133, the Accounting for Hedging Activities.

We believe that all financial assets and liabilities should be reported at fair value (please see our comment letter re: Fair Value Measurement for Financial Instruments, dated May 23, 2008). Measuring all financial instruments at fair value in the balance sheet with changes reported in the income statement accompanied by sufficient disclosure in the footnotes, would increase the transparency of financial reporting, and have the major benefit of eliminating the need for special hedge accounting. Such an improvement would enhance investors' understanding of a company's operations and of its returns and risks. At the same time, these changes would reduce the complexity of financial reporting, and improve the relevance of financial reports, if applied on a consistent basis to all financial assets and liabilities.

¹ This letter represents the views of the ITAC and does not necessarily represent the views of its individual members, the organizations in which they are employed, or the views of the Financial Accounting Standards Board ("FASB" or "Board") or its staff. For more information about the ITAC, including a list of the current members and the organizations in which they are employed, see http://www.fasb.org/investors_technical_advisory_committee.

While the simplest and most transparent accounting would be to have all financial instruments reported at fair value, we support the general thrust of FASB's progressive proposal to revise Statement No. 133. The proposal represents movement towards achieving the objective of financial reporting stated herein. Importantly, the proposal is also consistent with the direction of IFRS as suggested in the Discussion Paper entitled 'Reducing Complexity in Reporting Financial Instruments.'² ITAC intends to provide more specific comments on that Discussion Paper in a separate letter to the FASB and IASB.

We believe the proposed Statement would improve the usefulness of financial statements by requiring measurement of all changes in fair value of both the hedging instruments and hedged items. Moreover, the reporting of hedged financial assets and liabilities at fair value, accompanied by sufficient disclosures, would provide more insight into the alternative approaches companies take in risk management, and would provide investors with a sense of context in judging the company's hedging strategy. A degree of subjectivity is involved in the assessment of the need for hedging and whether the hedging undertaken by companies serves a business purpose or is motivated by financial speculation. The proposed Statement, combined with more useful disclosures, would allow for a more careful review by investors of a company's hedging strategy.

However, we have some additional recommendations that we believe would further improve the clarity of reporting for derivatives while also simplifying the preparation of the reports for preparers. Our recommendations will be provided both in our commentary on specific issues, as requested in the Exposure Draft.

Hedged Risk - Issue 1

We agree that eliminating "the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge" (with two exceptions) would more comprehensively reflect risk exposures while, at the same time, eliminate the arbitrary and error-prone bifurcation of risk effects associated with hedged assets and liabilities.

As has often been observed, no perfect hedges exist, and, therefore, hedging transactions entered into in order to achieve legitimate risk management or other risk distribution reshaping objectives (e.g., transactions that would increase a company's risk exposures that are explicitly admitted for hedge accounting treatment under Statement No. 133) must necessarily subject the company to other than the target risk(s). Thus, investors and other users are better served by having relevant information on a company's complete risk exposure profile, consistent with full fair value reporting for financial instruments.

In this regard, one of the provisions in the original Statement No. 133 that impaired its usefulness to investors was the provision that required only the revaluation of that portion of a particular risk hedged in a position. For example, if a company chose to hedge only

² IASB Discussion Paper, Reducing Complexity in Reporting Financial Instruments (issued March 19, 2008) and FASB Invitation to Comment, Reducing Complexity in Reporting Financial Instruments (issued March 28, 2008), which includes a copy of the IASB Discussion Paper.

40% of the price risk in a particular commodity inventory, then only 40% of the hedged item would be marked to market for the hedged risk, leaving the remaining 60% at the original historical cost. This provision was a compromise engineered to reduce the volatility in earnings that might occur as a result of marking the unhedged portion to fair value. That is, an accommodation was made to those who, at that time, were concerned about the possible adverse effects of fully reflecting the effects of a company's full risk profile in the primary financial statements.

In fact, however, investors may well be more concerned about the effects on the company's operations of the unhedged risk exposure than they would the hedged 40%. Hence, we believe financial reporting would be substantially improved if the Board were to take this opportunity of updating and revising Statement No. 133 to eliminate this reporting loophole and require that the full amount of a hedged position be fair valued, thus making clear the effects on a company's operations of the decision to hedge as well as the decision to not hedge and bear a portion of the risk.

We agree with the provision in paragraphs 17 and 18 that the designation of a hedge of interest rate risk in issuance of own debt should be designated at inception. However, the expression "within a reasonably short period" seems to us to be unnecessarily ambiguous and vague and is likely to provide ample opportunity for gaming. We recommend clarifying what is meant by "within a reasonably short period."

We note that the accounting and financial reporting for cash flow hedges remains exceedingly complex and convoluted. Indeed, a significant portion of the Exposure Draft is devoted to the various provisions necessary to achieve the desired accounting effect. The underlying problem that these elaborate provisions are addressing is the desire to defer gains and losses on the hedging instrument in accumulated other comprehensive income in order to be able to match them with the effects of the forecasted hedged item at some indeterminate future time, a period which could stretch for decades into the future.³

As a matter of policy, we do not believe that the deferral of gains and losses can be justified for any reason and that such provisions both impair transparency and the usefulness of financial reporting for investors. We would encourage the Board to reconsider these provisions with a view to eliminating the deferral provisions of cash flow hedges. Such a change would not affect in any way a company's ability to continue to hedge such risk exposures. However, it would greatly improve the integrity of financial reporting. Any concerns managers have regarding users' understanding of the nature of the transactions could be fully dealt with in disclosures in the footnotes to the statements.

Hedged Risk -Issue 2

While we have some sympathy with the Board's decisions, explained in paragraphs A18-20, to both (1) encourage company managers to seek the lowest possible borrowing costs

³ For example, see Bloomberg article by Jonathan Weil dated December 5, 2007.
http://www.bloomberg.com/apps/news?pid=20601039&refer=columnist_weil&sid=ahoxGPj68WN0

available to it by entering into synthetic transactions that have the effect of achieving this objective, and (2) to actively manage foreign currency risk exposures, a major consideration in markets at present, we would note that this accommodation comes at the cost of underreporting other risk exposures, e.g., counterparty risk, that would otherwise be reported under the proposed amended Statement No. 133. That is, counterparty risk would be recognized in all transactions except those covered by the two exceptions. Given that the effectiveness test for the two exceptions would include only the risk managed, and not other risks, we are concerned that, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship. If companies synthetically convert issued debt to reflect the net terms that they desired when they issued the debt with related hedges, investors should have sufficient information disclosed to understand the effects on the financial statements of these synthetic transactions.

Hedge Effectiveness - Issue 3

We understand that confusion, abuse and restatements have resulted from implementing the shortcut method. We agree with the provisions in the Exposure Draft that “would eliminate the shortcut method and critical terms matching.” These changes would remove the ability for managers to “assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings during the term of the hedge”. Financial reporting should not be based on such entity specific or manager assumptions; rather, financial reporting should be based on objective evidence about effectiveness, which should be updated at each reporting period. Indeed, the elimination of the shortcut method would be entirely consistent with what we understand to be the spirit of these proposals, to more fully reflect company exposures and risk profiles.

The fact that this proposal would also enhance consistency and comparability in reporting for hedging transactions, both within companies across time and across different companies, while it also reduces complexity in financial reporting, are added attractions.

We do not see any “significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships.” Indeed, if managers seek to manage risk exposures by entering into hedging transactions, it is a fundamental presumption that they must be able to measure the fair value of the positions being managed.

We agree with the provision in paragraph 11 that managers electing hedge accounting under Statement No. 133 be required to consider counterparty risk in their evaluation of effectiveness. Indeed, we believe that all risks that could affect the fair value of a hedging instrument or any other financial instrument, including liquidity risk (e.g., the inability to exit an OTC instrument) should be taken into account.

Hedge Effectiveness - Issue 4

We do not believe the Board has adequately articulated the basis for loosening the assessment requirement, from “highly effective” to “reasonably effective.” Moreover, it is unclear to us how “reasonably effective” would be defined. We assume that this amendment was proposed to accommodate the reporting of fair value changes in all risks rather than just a single designated risk. However, our main concern is that the lower standard would permit greater deferral of derivative gains and losses from earnings under the guise of cash flow hedging, a concern we discussed above under Issue 1.

It is also not clear to us what qualitative or quantitative differences in practice would occur as a result of a reduction of the effectiveness requirement. Although a rule of thumb approach to the assessment of “highly effective” of 80%-120% offset has frequently been applied under Statement No. 133, this practice was a carry-forward from earlier standard setting and not an explicit provision of Statement No. 133 itself. Hence, we have no way of assessing what practices have been actually applied on average.

However, if managers decide to enter hedging transactions as a way of managing one or more risk exposures and also qualify for hedge accounting, we believe that such a financial-reporting decision should be allowed, subject to the documentation requirements of the revised Statement No. 133 and the “managed risk exposure” documentation requirements of the SEC.

Yet again, we must observe that if all financial assets and liabilities were required to be measured and reported at fair value, such a concern would not arise in the first place. Managers would enter transactions in financial instruments, including hedges, that they deem appropriate and the fair value measurement would report the effects of the transactions each period.

In this regard, to the extent that the reduction in the effectiveness threshold may be fueled by concern about the “in-and-out” problem of hedge accounting as a result of changes in hedge effectiveness over time, we believe that this concern is misplaced. The “in-and-out” problem is merely an artifact of the rather arbitrary provisions of hedge accounting that full fair value measurement would eliminate.

We are not opposed to the proposed accounting changes for hedge effectiveness as long as they are accompanied with sufficient disclosure requirements. For instance, to assist users in assessing risk management strategies, companies should be required to present, in tabular form where possible, the following information, by financial-statement-line item: the fair value of hedging instruments linked with the fair value amount of their hedged items; the corresponding changes in the hedges and hedged items during the period; the amount of hedges that ‘moved out’ of hedge accounting during the period due to ineffectiveness; the total amount and changes during the period of hedges not under hedge accounting; and useful descriptions of the hedge transactions.

We appreciate that Statement No. 161 should facilitate the ability for users to assess the effective vs. ineffective portions of fair value hedges by contract, and of cash flow hedges (assuming this distinction is made clear by disclosures of the changes in the fair value of hedges in the income statement vs. those in Accumulated Other Comprehensive Income). However, for these disclosures to be useful, we recommend the required presentation of the effective vs. the ineffective portions by line items in the financial statements. Furthermore, we recommend that the disclosure requirements required under Statement No. 161 be expanded or clarified to also require disclosures of the entity's accounting policies and attributes (qualitative and quantitative). These should include how the company assesses hedge effectiveness, both at and after inception, as well as the "circumstances that may suggest that a particular hedging relationship may no longer be sufficiently effective." Moreover, the Board should also emphasize disclosures of the company's risk exposures and the strategies it employs to manage such risks using derivative and other asset-liability management practices. This is particularly relevant since hedged risk under the proposed Statement must be the risk of all changes in fair value of the hedged item or all changes in the hedged cash flows (with two exceptions).

Hedge Effectiveness – Issues 5 and 6

We have some concerns about the provision to "require an effectiveness evaluation at inception of the hedging relationship," but to suspend such requirements following inception, relying instead on managers' "creating processes that will determine when circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness each reporting period."

Hedge accounting is both voluntary and selective in nature, a departure from the usual and normal accounting for items. Therefore, we believe that it would be reasonable to require a continuing periodic assessment of the effectiveness of the hedging arrangement if the election were to be continued.

However, our primary reservation about this provision stems from our belief that if managers properly measure and report the values of hedges and hedged items each reporting period, given that the shortcut method and related assumptions about effectiveness would no longer be permitted, managers would necessarily have to generate the information they would need to make the assessment, and thus, the evaluation would require little if any additional effort. Consequently, the underlying motivation for this provision is not clear to us.

To the extent that this provision may be driven by concerns about "in-and-out" accounting or other such operational matters, we believe for the reasons we provided in the previous section that the concerns are, again, misplaced.

Finally, if the Board is indeed concerned about "in-and-out" effects, the ultimate solution is not to eliminate requirements for monitoring of hedges—a provision of dubious financial reporting merit—but to require that hedges once so designated for hedge accounting purposes not be permitted to be "de-designated" until either the hedging

derivative is sold or otherwise terminated, or the hedged position is similarly sold or terminated. That is, the election would be permanent and irrevocable.

Managers now have available the provisions of Statement No. 159 which, for hedged financial assets and liabilities, could achieve the same fair value financial reporting effect as Statement No. 133, but in a simpler and more straightforward fashion. Thus, if managers choose to elect hedge accounting under Statement No. 133, a somewhat more cumbersome alternative, a requirement that it be a permanent election would remove some of the operational problems and potential gaming that might otherwise occur, while at the same time simplifying reporting.

Presentation of Hedging Gains and Losses - Issue 7

It should not be necessary to amend Statement No. 133 to prescribe the presentation of gains and losses associated with hedging instruments if the disclosures in Statement No. 161 are sufficiently robust. While we believe it is essential to have it made clear on the face of the financial statements the line items where fair value gross gains and gross losses are included, and their amounts, we believe that the usefulness and transparency of the information produced under Statement No. 133 should improve considerably due to the disclosure requirements of Statement No. 161. We are hopeful that the Joint Financial Statement Presentation Project will go a step further and make the gross gains and losses even more transparent on the face of the financial statements. However, if it is not contemplated that Statement No. 161 will achieve these objectives, then, by default, the disclosures must be required in Statement No. 133.

Investors must be able to ascertain where the gains and losses are classified in the financial statements and need retrospective disclosure if managers are free to change the classification and presentation from period to period. Without such presentation and disclosure, comparability across companies is impaired.

Effective Date and Transition – Issue 8

We believe that the effective date provides sufficient time not only for managers to adopt the provisions but to adjust either their hedging programs or financial reporting standards, e.g., by electing to report such arrangements under Statement No. 159 if they choose.

Given that the proposals in these revisions would eliminate much of the complexity and simplify the financial reporting, we do not believe that they would prove problematic for preparers.

Effective Date and Transition – Issue 9

We believe that it would enhance transparency if managers were to provide sufficient qualitative and quantitative disclosure to enable investors and other users to understand what managers' intentions are regarding their election of the either the proposed Statement No. 133, or alternatively, Statement No. 159 if they choose to elect the Fair

Value Option for their hedging transactions going forward. Specifically, the transition disclosures should provide information on transfers between the held-to-maturity and the available-for-sale or trading categories; re-designation of hedged items to fair value accounting under Statements No. 156 and 159; and the amount of adjustments made to the carrying values of assets or liabilities.

Due to the de-designation and re-designation requirements of the proposed Statement, there potentially may be meaningful changes in positions or elections to qualify for hedge accounting. We believe that the Board should require disclosure of changes to hedge relationships or elections to apply hedge accounting as a result of the application of the proposed Statement and a discussion of effects on comparability of reported results across periods.

Effective Date and Transition – Issue 10

We agree with the Board’s decision “to permit an entity a one-time fair value option election under FASB Statement No. 156, Accounting for Servicing of Financial Assets, and No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, for (a) servicing assets and servicing liabilities designated as a hedged item on the date immediately preceding initial application and (b) eligible financial instruments designated as a hedged item on the date immediately preceding initial application of this proposed Statement.”

However, we do not agree with the proposal in paragraph 38 to permit “the net effect of the adjustment [to be] recorded directly to retained earnings.” As a matter of policy, gains and losses on assets and liabilities, regardless of their source, i.e., whether from fair value or other operational changes or from changes in accounting principles, voluntary or mandatory, should not be permitted to escape immediate and full recognition in net income. Allowing any such recognition loopholes reduces the integrity of financial reporting for all users of financial statements, including investors, and should not be allowed.

Consequently, we would encourage the Board to reconsider these provisions and to require that any adjustments be required to be recognized in income with appropriate disclosure in the footnotes.

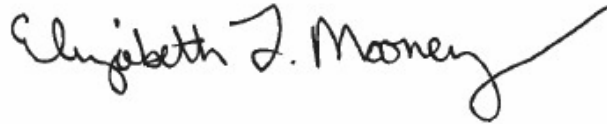
Benefit-Cost Considerations – Issue 11

In assessing the benefit-cost considerations, we strongly encourage the Boards to consider the costs to users of not having the transparency or the improved financial reporting that would result from the changes in the proposed Statement accompanied by our recommended disclosures.

Thank you for your consideration of our views on accounting for hedging activities and fair value reporting for financial instruments, which we view as critical in strengthening investor confidence in financial reporting. If you need further clarification or require

additional information, please feel free to contact the undersigned or any other member of ITAC's Hedging Subgroup. We would be pleased to discuss our recommendations with members of the Boards or their staff.

Sincerely,

A handwritten signature in black ink that reads "Elizabeth F. Mooney". The signature is written in a cursive style with a long, sweeping tail that extends to the right.

Elizabeth F. Mooney
Member

cc: Russell Golden, Technical Director, FASB
Kevin Stoklosa, Assistant Director of Technical Activities, FASB
Gavin Francis, Director of Capital Markets, IASB