



Commodity Markets Council
1300 L St., N.W. Suite 1020
Washington, DC 20005
Tel 202-842-0400
Fax 202-789-7223
www.cmcmarkets.org

COMMODITY MARKETS COUNCIL

Policy Discussion: Regulatory Issues

Financial Accounting Statement 133

CMC's Objective

CMC is the industry's leading advocate to reform FAS 133 and alleviate the distortions it causes in financial statement reporting. CMC coordinates a Coalition that works closely with the Financial Accounting Standards Board and its staff.

CMC Action

- | | |
|----------------|---|
| May 2007 | FASB adds a FAS 133 project to the Board's agenda. The Board instructed staff to review the "fair value approach," which would eliminate critical terms matching and assessing effectiveness. |
| August 2007 | CMC successfully secures a seat on the FASB Resource Group. The Resource Group includes industry representatives and consults with FASB staff on the recently launched FAS 133 project. |
| September 2007 | CMC hosts FAS 133 panel at the Mid-Year Meeting.
CMC Coalition submits comments as part of the FASB Resource Group. |
| January 2008 | CMC hosts a Coalition conference call with FASB staff to discuss the status of the FAS 133 project and explore other related issues. Coalition decides to hold any comments until FASB releases an exposure draft in February or March. |

Issue Summary

FAS 133 increases systemic risk by forcing suppliers to carry the hedging instruments on behalf of the processors and by causing processors to move from the protection of standardized exchange-traded contracts to off-exchange products. Amending FAS 133 will alleviate distortions in financial statement reporting and allow processors to return to standard practices.

In May 2007, FASB considered three approaches to modifying FAS 133, but has focused on one approach – the fair value approach. This method eliminates critical terms matching and assessing effectiveness. For fair value hedges, the derivative and the hedged item would be measured at fair value with changes in value recognized in earnings. For cash flow hedges, the derivatives would be measured at fair value with the effective portion of the gain or loss reported in other comprehensive income, and the ineffective portion reported in earnings.

CMC Position Summary

The CMC Coalition is waiting for an exposure draft before submitting any additional comments to FASB. In September 2007, the CMC Coalition submitted the following comments to the Board as part of the FAS 133 Resource Group. Highlights include:

- Fair value hedge accounting for nonfinancial instruments should be permitted; however, sustaining this accounting model is less important than clarifying the scope and accounting model in the FASB's project to evaluate the accounting for commodity inventories pursuant to ARB 43.
- Cash flow hedge accounting should continue to be permitted for the variable cash inflow/outflow of an existing financial asset or liability under a full fair value approach. In many instances, the derivative

contract acquired to hedge such an exposure has a component of its value that relates to a future cash inflow/outflow that has not been recognized in current earnings. Eliminating the ability to defer accumulated OCI or OCL the change in the value of a derivative that relates to those future cash inflows/outflows will create volatility in current earnings not reflective of the economics of the underlying transactions.

- We also believe it is imperative that the FASB better define its requirements for documentation of these types of hedges, including the SEC's recent guidance on the application of the critical terms match method of assessing hedge effectiveness. The detailed rules provided in SFAS 133 are complex. As a result, they are not uniformly followed.
- Several companies opt not to perform the SFAS 133 assessments of hedge effectiveness because they believe the requirements are so onerous and inherently risky, that it is better to accept the resulting volatility in earnings and disclose in detail its impact on their financial statements. However, this decision should not be misinterpreted as preferable to hedge accounting.