

**MEMO# 8326**

October 15, 1996

## **INSTITUTE COMMENT LETTER ON FASB EXPOSURE DRAFT**

1 Concurrent with the release of the Exposure Draft, the FASB issued for comment a separate proposal, Reporting Comprehensive Income. This proposal would require all non-owner changes in equity currently reported in the equity section of the balance sheet (e.g., adjustments to minimum pension liabilities (FASB Statement No. 87), unrealized gains and losses pertaining to available for sale securities (FASB Statement No. 115)) to be presented as a component of comprehensive income. Comprehensive income would represent an overall measure of enterprise performance and would include both net income and any other comprehensive income. October 15, 1996 TO: ACCOUNTING/TREASURERS COMMITTEE No. 41-96 INDEPENDENT ACCOUNTANTS ADV. GROUP No. 9-96 RE: INSTITUTE COMMENT LETTER ON FASB EXPOSURE DRAFT

The Institute submitted the attached comment letter to the Financial Accounting Standards Board on the exposure draft Accounting for Derivative and Similar Financial Instruments and for Hedging Activities. The Exposure Draft relates primarily to historical cost based entities that defer gains and losses on derivatives through "hedge" accounting. Accordingly, the accounting provisions of the exposure draft are not relevant to investment companies. Nonetheless, the Exposure Draft would require investment companies to provide additional financial statement footnote disclosures regarding their investments in derivatives. In particular, investment companies would be required to disclose the amount of gains and losses on derivatives during the reporting period disaggregated by class. Also, the Exposure Draft would broaden the definition of a derivative financial instrument to include structured notes. The Institutes comment letter questions the value of the proposed gain/loss disclosure by class of derivative and argues that gain/loss disclosure at the fund level, which is currently provided in the statement of operations, is more relevant to investors. The Exposure Draft would dramatically change the way historical cost based entities report derivatives transactions and hedging activities. The Exposure Draft would require such entities to recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. If certain conditions are met, a derivative may be designated as one of three types of hedges. "Fair value hedges" would result in the recognition in income of changes in the fair value of the hedged item to the extent the change in value of the hedged item offsets the gain or loss from the derivative. Changes in fair value of derivatives designated as "cash flow hedges" would be recorded in "other comprehensive income."<sup>1</sup> For a derivative designated as a "hedge of the foreign currency exposure of a net investment in a foreign operation," the portion of the change in fair value equivalent to foreign currency transaction gain or loss would be reported in other comprehensive income; any remaining change in fair value would be recognized in earnings. For a derivative not designated as a hedge, the change in fair value would be

recognized in earnings in the period of change. The Exposure Draft would supersede FASB Statement No. 80, Accounting for Futures Contracts, FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off- Balance Sheet Risk and Financial Instruments with Concentrations of Credit Risk, and FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments. It would amend FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, to be consistent with the measurement provisions of the Exposure Draft and to include in Statement No. 107 the disclosure provisions about concentrations of credit risk from Statement No. 105. The Exposure Draft would be effective for fiscal years beginning after December 15, 1997. Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment

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