Here’s how to use the Bloomberg Professional service to meet the new derivative-reporting accounting standards that are causing headaches for corporate treasurers.

EASING THE STRAIN OF FASB 133

By Michael Fuhrman

Since June 15, the Financial Accounting Standards Board (FASB) has required publicly traded U.S. companies to report all derivatives on their balance sheets at fair value. Gains or losses on these positions must be allocated to current earnings or other comprehensive income.

The requirement is causing difficulties for many companies. The Bloomberg Professional service provides a solution that combines derivative valuation analytics with live market data.

Though FASB Statement No. 133, a 200-page document, is complex, here’s a summary of some of its key points. (For a more detailed discussion, see www.kawaller.com.)

- FASB 133 applies to all publicly traded companies and is effective for all fiscal quarters of all fiscal years beginning June 15. The rule is not applied retroactively.

- For speculative purposes, derivative gains or losses must be marked to market, and gains or losses are realized in the current period’s income.

- In the hedging of exposures associated with the price of an asset, liability, or a commitment a company must meet, accounting for the derivative is the same as it is for speculative uses: The carrying value of the underlying exposure must be marked to market. Its change in value must be included in earnings. Any gains or losses from the derivative used to hedge that exposure must also be posted and will flow to the income statement.

- Gains or losses from derivatives must be evaluated and compared with the change in market value of the underlying risk. Corporations are required to determine how much of the result is “effective” and how much is “ineffective.” The ineffective portion of the hedge result must be realized in current income. The effective portion is initially posted to Other Comprehensive Income and later reclassified as income in the same time frame within which the forecast cash flow affects earnings. FASB recognizes hedges as being ineffective for accounting purposes only when the hedge’s effects exceed the effects of the underlying’s forecast cash flow, measured on a cumulative basis.

- The hedge associated with the currency exposure of a net investment in a foreign operation must be marked to market. This time the treatment maintains the current provisions of FASB Statement No. 52, which requires that effective hedge results be consolidated with the currency exchange adjustments in other comprehensive income. Differences between total hedge results and the adjustments being hedged become part of earnings.

How can the Bloomberg Professional service help meet these onerous requirements? By providing real-time pricing for listed interest-rate, currency, equity, and commodity derivatives from all of the major commodity exchanges.

Choose a fixed floating-rate swap by clicking on number one. Another page appears. Here, you enter information in the fields with red labels, the other fields will default to standard market convention. For example, tab down and enter a counterparty, ticker symbol, effective date, and maturity date as shown in figure 2. Enter a $ in the field between the words Fixed and Float; this indicates that the derivative pays a fixed coupon. Enter USD in the...
Using the first page of SWAP, you can run scenario analytics. Type 3 <Go> to see how your derivative will perform under various parallel and custom yield curve shifts. In this way, you can stress test the derivative's performance under various interest-rate scenarios and compare it with the underlying's exposure going forward.
As you examine future rate scenarios, you might also try the Forward Curves Analysis Menu function. This lets you project forward rates for fair market curves, swap curves, or government curves at three future dates. By typing FWCV US <Go>, you can see forward curves implied by the U.S. dollar swap curve (SWYC23) for a three-month, six-month, and one-year horizon. To view graphs of the three forward curves, type 1 <Go>. To see implied forward rates at various frequency intervals, type 3 <Go>. It’s also worth noting that you can do similar future-scenario analysis on currency derivatives using such functions as Spot & Forward Rates (FRD) and FX-Forward Rate Arbitrage (FXFA).

Along with entering one swap transaction, you may want to value a group of derivatives. Type PRTU <Go> 1 <Go> to create a portfolio. Then enter a portfolio name, and press <Go>. The system automatically assigns a portfolio number. Press <Page Fwd> to build your portfolio.

In this example, let’s enter two securities: the /MAG 7.25 percent 2005 swap and the DaimlerChrysler AG 7.75 percent 2005 bond. The system lets you load swaps, caps, floors, floating-rate agreements, equities, equity derivatives, and currency derivatives into a portfolio. You can use the portfolio setup function to create separate portfolios by asset class: investment-grade, high-yield, emerging-markets, or fixed-income derivatives.

To enter the swap, type the PP number and press <Corp>. It isn’t necessary to indicate a position, because the function picks up the swap’s $10-million notional amount. Corporate bonds are recorded by typing the ticker symbol, coupon, and maturity date and pressing <Corp>. For this example, you’ll enter a 10,000 bond or $10-million position and press <Go> (figure 4).

Now let’s look at some risk analytics for a portfolio of swaps—analytics that may come into play when complying with FASB 133. Type PLST <Go> for the User Portfolio Listing function—to see a list of your portfolios. Type the number of the portfolio you just created followed by <Go> SWPR <Go>. The Swap Portfolio Report Set-Up function lets you create and run five customized reports on any portfolio. The reports will run with live market or historical prices. To run the reports with historical data, enter the desired date in the CURVEDATE field. Begin by giving the report a name. Let’s look at one called Market Value. Moving from left to right, you must set up several columns. In the Curve column, enter a number from one to five (codes are on the right side of the screen) to indicate where the report writer should look at the swap curve to capture rates. In this case, choose three, the midpoint. Next, you’ll format each column by keying in a number. There are 41 choices, and the codes appear at the bottom of the page. Here, opt for numbers 2 (pay coupon), 3 (receive coupon), 6 (maturity date), 11 (premium), and 17 (pay notional amount). To run the report, type 1 <Go>. To check on the status of the report, type RPT <Go> (figure 5). To see the report shown in figure 6, type 1 <Go>.

The report breaks out aggregate information on page 1 and detailed deal-by-deal information on page 2. Page 1 shows totals for the entire portfolio: net market value, net accrued interest, net risk, net basis-point value, and totals for notional, principal, and duration. The report says there is one swap in the portfolio, and it’s using the mid rates of the swap curve for valuation. Grid point deltas (dollar exposure for a one-basis-point yield curve shift) are listed on the right side of the screen for each point on the curve.

The second page shows deal-by-deal information displayed according to criteria you’ve selected in the SWPR template. Type 0 <Page Fwd> to see the last two columns of formatted information.

You can use the Custom Report Writer (PRPT) function to create three-dimensional custom reports that look at the portfolio as a whole, by groups or buckets, and on a security-by-security level. PRPT lets you set up risk analytics for fixed-income, equity, and currency securities so...

**FIGURE 4**

**Step 1**
Type PRTU <Go> 1 <Go>. Tab down, enter a portfolio name, and press <Go> <Page Fwd>.

**Step 2**
Tab down and enter the securities and position as shown. Press <Go>.

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or build your own by clicking on the new report option on the left side of the screen.

Click on number 61—the Duration Sort 1-Way report—to sort securities into duration groups. Enter 2 <Go> to copy the report to your custom report list. To change you can compare the performances of a group of assets with the derivative hedges.

Start by typing PRPT <Go> for the main menu to format your report templates. You can use any of the ready-made reports that appear on the right side of the screen the report’s setup, click on the menu number in the Set Up column corresponding to the Duration Sort 1-Way report. The report is divided into three parts: the summary page (type 2 <Go>), the grouping page (type 3 <Go>), and the security-level page (type 4 <Go>). You can format each section by typing the appropriate number.

Type 2 <Go> to see the Setup Summary Page. There are 16 lines or fields of information that you can format. Any field can be deleted or modified by typing the number of the field and pressing <Go>.

To add some information to line 14, for example, type 14 <Go>.

The summary page appears after you format each section of the report. The top half represents the available fields on the summary page. The bottom half contains thousands of data fields. In essence, you have access to Bloomberg's data library.

Now type 13 <Go> to add in line 13 an entry of the summary page. The system opens a window for data selections for line 13 on the summary page.

If you decide to enter some information about risk measures, type 27 <Go>. This corresponds to the choice in the bottom half of the screen.

Select the MID YIELD VALUE OF 1/32 data field by typing or clicking on number 21. The data field now populates line 13 on the summary page. Press <Menu> once to make other changes. Press <Menu> again to go back to the summary page. Repeat this process to format each of the three sections of the report.

Press <Menu> two times to return to the first page of the report writer. Launch your reports by typing their numbers as listed in the Run column and pressing <Go>. These reports run offline so that you can use your terminal during the process. In addition, you can enter a Y in the PRINT REPORT WHEN YOUR UNIT? field on PRPT and the report will print at the same time as it runs.

Compliance with FASB 133 clearly isn’t easy, but the aforementioned techniques make it possible.