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ACCOUNTING

A Pain in the FAS

By Jay Sherman

A fact of life for most companies, FAS 133 has many favoring plain over exotic

Ask Jay Fitzsimmons what he thinks about Financial market derivative holdings and record gains or losses into the profit-and-loss statement, has resulted in the execution of deals that are less than optimal. “There are a lot of good treasury deals that have to be rethought because they won’t get P&L treatment” under FAS 133, Fitzsimmons says.

He ought to know. Fitzsimmons, senior vice president of finance and treasurer at retail giant Wal-Mart Stores Inc., cites two seemingly similar derivatives transactions with like risk profiles that wound up getting very different accounting treatment for the Bentonville, Ark.-based company, thanks to FAS 133. The first involved a European subsidiary issuing debt through a swap. Last year, that deal—a £500 million, 30-year bond offering—generated a gain for Wal-Mart and received P&L treatment. Yet when Wal-Mart set up a British subsidiary solely to raise funds in Britain through a

structure did not allow the retailer to record the gain to Wal-Mart’s bottom line. “We ended up doing the deal anyway because we still got the cash flow,” Fitzsimmons says. “But it’s illogical. There was no difference in the risk of either deal, so why were they treated differently?”

Welcome to life under FAS 133. Since the controversial accounting standard took effect nearly 18 months ago, treasury shops throughout corporate America have been facing questions similar to Fitzsimmons’. Often, the answers aren’t easy. While the initial fear and loathing that surfaced when FAS 133 took effect in October 2000 has largely passed, with many of the worst-case scenarios not coming to fruition, the sailing with FAS 133 hasn’t been exactly smooth. Ford Motor Co., for example, took a charge of \$252 million in 2001 for hedges and derivatives the company had to mark to market under FAS 133. Clearly, not the best timing for the car maker.

Smaller Companies Hit Hardest

Still, most larger organizations were all-hands-on-deck for the new rule’s introduction, and that has allowed them to anticipate and avoid potential potholes. According to *Treasury & Risk Management’s* 2001 Derivatives Survey released last October, 67% of the respondents claimed they hadn’t changed their derivatives strategy in light of FAS 133, and 68% reported their earnings statements had not been affected by the

transaction that would swap U.S. dollars for sterling, FAS 133 rules said the emergence of the rule (*T&RM*, October 2001).

The hardest hit have been small and midsize companies that had limited experiences using derivatives even before FAS 133. Those enterprises “that were not major users of derivatives are now waking up to the reality of a new regime that they aren’t really ready for,” says Ira Kawaller, president of Kawaller & Co., a New York treasury consulting firm. And stories of large financial hits, such as Ford’s are doing little to calm their nerves.

The Case for Vanilla

So FAS 133 has turned out to be little more than just another reporting annoyance? Not entirely. It actually is making companies smarter when it comes to derivatives, demanding that they, for the first time, pull back the layers and understand hedges that heretofore were known only at a cursory level. “[The rule] really forces companies to take a look at their policies on risk,” says James Haddad, vice president for corporate finance at Cadence Design Systems Inc. in San Jose, Calif., and chairman of the Association for Financial Professionals’ financial accounting and investor relations task force.

FAS 133 also has kept many treasury operations from dabbling in the exotic. “People have learned that the plain vanilla, the simple, works as advertised,” says

Kawaller, who, along with others, says that the accounting rule has had little impact on simple hedges. “But for non-financial entities that were doing interest-rate or currency swaps, FAS 133 has been another story.”

Making the task even more challenging for companies large and small is the reality that the rule has morphed into a document that stands at nearly 800 pages at last count, thanks to numerous amendments and clarifications. “In the first 18 months we have worked through a lot of questions,” says Timothy S. Lucas, director of research and technical activities of the Financial Accounting Standards Board, which polices the accounting industry and is responsible for all U.S. accounting standards, including FAS 133. But while the heavy lifting is over, Lucas acknowledges that there is still work to be done. Among key problem areas: accounting for beneficial interests and deciding which interest contains an imbedded derivative.

No doubt, that should translate into another 100 or 200 pages at least.