Statement of Financial Accounting Standards No. 137

FAS137 Status Page

Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133

an amendment of FASB Statement No. 133

June 1999

Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 137

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CONTENTS

Paragraph Numbers

FAS 137: Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133

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INTRODUCTION

1. FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* was issued in June 1998. It establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. As issued, Statement 133 is effective for all fiscal quarters of all fiscal years beginning after June 15, 1999, with earlier application encouraged.

2. The Board received requests to consider delaying the effective date of Statement 133. Entities and their auditors requested more time to study, understand, and implement the provisions of that Statement as they apply to entities' transactions and circumstances. Entities also requested more time to complete information system modifications. The Board concluded that, for the reasons presented in the appendix to this Statement, it is appropriate to defer the effective date of Statement 133. However, the Board continues to encourage early application of Statement 133.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Amendments to Statement 133

3. Statement 133 is amended as follows:

a. The first sentence of paragraph 48 is replaced by the following:

> This Statement shall be effective for all fiscal quarters of all fiscal years beginning after June 15, 2000.

b. Paragraph 50 is replaced by the following:

> At the date of initial application, an entity shall choose to either (a) recognize as an asset or liability in the statement of financial position all embedded derivative instruments that are required pursuant to paragraphs 12–16 to be separated from their host contracts or (b) select either January 1, 1998 or January 1, 1999 as a transition date for embedded derivatives. If the entity chooses to select a transition date, it shall recognize as separate assets and liabilities (pursuant to paragraphs 12–16) only those derivatives embedded in hybrid instruments issued, acquired, or substantively modified by the entity on or after the selected transition date. That choice is not permitted to be applied to only some of an entity's individual hybrid instruments and must be applied on an all-or-none basis.

Effective Date

4. This Statement is effective upon issuance. An entity that has already applied the provisions of Statement 133 and has issued interim or annual financial statements reflecting that application may not revert to a previous method of accounting for derivative instruments and hedging activities.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. Cope and Foster dissented.

Messrs. Cope and Foster dissent from the issuance of this Statement. They disagree with the conclusion that the benefits of delay outweigh the advantages of prompt implementation. They are concerned that users of financial statements will continue to be deprived of information that has long been recognized as critical to the investment decision-making process. Lack of transparent recognition and consistent accounting for derivatives and hedging transactions has already led to substantial investor losses that could have been avoided had there been proper accounting and disclosures. As the number and variety of derivative transactions expand, and considering increased market volatility, they believe that, without appropriate accounting and disclosure, the risk of investors and creditors incurring unanticipated losses in the future remains high. Users of financial statements need to know what risk exposures exist or do not exist. The implementation of Statement 133 will contribute significantly toward meeting that need, and Messrs. Cope and Foster believe that its implementation should not be delayed.

Mr. Cope also believes that, although the provisions of paragraph 3(b) are a logical extension of a decision to defer implementation of the entire standard, the result is a complication and extension of the transition period during which it will be even more difficult for investors to make valid comparisons between entities. That transitional problem would be avoided if the

Statement was not deferred.

Mr. Foster also believes that the change in the transition requirements set out in paragraph 3(b) is inappropriate. The Board's constituents have known since June 1998 when Statement 133 was issued that they would be required to account separately for derivatives embedded in complex financial instruments entered into on or after January 1, 1998. Mr. Foster sees no reason to grandfather the accounting for any more embedded derivatives than those that were originally grandfathered by Statement 133.

Appendix: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

5. At the time Statement 133 was issued in June 1998, the Board was aware of the complexities associated with transactions involving derivative instruments and their prevalent use as hedging instruments. Because of that, even before Statement 133 was issued, the Board established the Derivatives Implementation Group (DIG) to assist the FASB in answering questions that companies might face as they began implementing the Statement. Additionally, early on, the FASB developed an educational course on implementing Statement 133, which has been widely used.

6. Despite the anticipatory effort extended by the Board to address implementation issues, some preparers of financial statements and auditors expressed concern about certain challenges they face in applying Statement 133. Those challenges include organization-wide educational efforts and information system modifications.

7. The educational challenges relate mainly to the scope of the Statement and the new approach to recognizing and measuring hedge effectiveness. Statement 133 has a potentially pervasive effect that requires an understanding of technical issues that span several functional areas in some organizations. Constituents expressed concern that they simply have not had enough time to master the new accounting requirements and their implications for derivative and hedging transactions throughout their organizations. In many cases, there may be an unanticipated need to modify existing contracts that currently include embedded derivatives.

8. The Board was informed that the ability to modify or develop information systems in response to Statement 133 is hindered by the level of effort required to modify and test those systems to ensure their proper operation in the year 2000. Constituents reported that those required information systems modifications consumed more resources than expected. In turn, information systems resources were unavailable to ensure compliance with Statement 133. Many companies have imposed moratoriums on information systems changes during the third and fourth quarters of 1999 that will extend through the first quarter of 2000. That has created obstacles that were unanticipated by the Board and constituents when the original effective date of the Statement was selected.

9. The Board believes that the issues identified by constituents regarding the difficulties associated with implementation will prevent many of them from achieving a sound and consistent implementation of Statement 133. The Board was requested to consider different types of deferrals that included rolling effective dates for DIG conclusions and deferring selected provisions of Statement 133 that were of particular concern to some constituents. The Board decided that the simplest and most effective alternative was a complete deferral for a period of one year.

10. With a delayed effective date, the Board remains concerned that users of financial statements will be deprived of information that the Board continues to believe is critical. Nonetheless, the Board believes that the disadvantages associated with immediate implementation, particularly inconsistent application of the standard caused by lack of adequate information systems, outweigh the benefits of requiring immediate implementation. A one-year deferral will allow constituents to overcome the educational and information systems challenges they currently face. The Board believes that the deferral of the effective date of Statement 133 will not only facilitate its adoption but also enhance consistent application of its provisions for the ultimate benefit of users.

11. On May 20, 1999, the Board issued an Exposure Draft, *Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133,* which proposed deferring the effective date of Statement 133 for one year. The Board received 77 letters of comment from respondents. There was overwhelming support for the Board's decision to defer the effective date of Statement 133. Two respondents requested that the Board consider deferring the date that differentiates which hybrid instruments in existence at the date of initial application must be analyzed to determine whether the related embedded derivatives are required to be separated from host contracts. The Board concluded that was a reasonable request given the change in the effective date of Statement 133. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing and that the effective date specified in paragraph 4 is advisable in the circumstances.