

New Disclosures for Derivatives

Given that the accounting for derivatives is complex, the related disclosures were often equally hard to understand. To clarify those disclosures, in March 2008 the FASB adopted FAS 161, "Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133" (now codified as ASC 815). The new disclosure rules apply to all interim and annual reporting periods beginning after November 15, 2008, and companies are encouraged to provide the same disclosures for prior periods. The overall objective is for financial statement users to gain a better understanding of:

- 1) How a company uses derivatives and the reasons why;
- 2) How a company accounts for derivatives and related hedged items; and
- 3) How derivatives and related hedged items affect a company's financial statements, performance and cash flows.

Financial statements must provide more transparency of derivative financial information. In addition, the disclosures must address the following questions in each full set of financial statements:

- Why do you use derivatives?
- What underlying risks are you trying to manage?
- What accounting designations apply?
- What is the volume of your derivative activity?
- Have you prepared tabular summaries of the fair values of derivatives and the related gains and losses on an instrument-by-instrument basis, etc.?
- What is the nature of credit-risk-related contingent features within derivative instruments that are in a net liability position?

Items to note:

- Companies need to analyze their history of derivative activity to determine what information would best meet the disclosure objectives of the standard. Companies can select the most appropriate disclosure format and content based on their facts and circumstances.
- It is possible that amounts included in the new disclosure

will not agree with the amounts presented on the face of the balance sheet since the tabular disclosure must be prepared on an instrument-by-instrument basis.

Companies may wish to reconcile the amounts in the tabular format to the amounts reported in the balance sheet.

- To reduce the effort needed to prepare the information at each period-end, a company that has a large volume of derivative activity may wish to identify and track features in all its derivative instruments that presently are or could eventually become a net liability.
- Companies should consider whether their information systems and internal control policies and procedures for derivatives and hedging activities need to be modified, including data collection and verification procedures, review processes, and controls over the new disclosure preparation.

The changes involve complex issues with wide-ranging implications. All companies are urged to analyze the new rules carefully, as stakeholders (e.g., lenders) will likely read these new disclosures very carefully.

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