Companies Are Not Using FAS 33 Data

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CEO Interview

GAO: Uncle Sam's Auditor
By Kathy Williams
Since its inception in 1921 as a federal budget watchdog, the General Accounting Office has evolved into an evaluator of all government programs and systems. Under the leadership of Comptroller General Charles A. Bowsher, a former partner with Arthur Andersen & Co., its latest and most comprehensive project is restructuring the government’s financial management system. If adopted, the new system would feature uniform accounting principles and standards and would show clearly what government services and programs cost and why.

High Tech

Accounting for the Factory of the Future
By David M. Dills and Grant W. Russell
The implications of the automated factory or Flexible Manufacturing Systems (FMS) are not yet fully understood by controllers and management accountants. But this new technology will force them to change their techniques to ensure that financial accountability will be present in the “Factories of the Future.”

Investments

Accounting for Commodity Futures
By Ted Siebers
If you ever wanted to make a plunge into the commodity futures market, here is a refresher course on just what the risks and rewards are. The ramifications of the FASB standard, “Accounting for Futures Contracts,” also are explored.

Annual Conference

Staying on Top of New Trends: St. Louis '85
By Donna Marks
MSA’s dynamic CEO John P. Imlay, Jr. will be a key guest speaker at the Annual Conference, June 23-26.

Cost

Companies Are not Using FAS 33 Data
By Kenneth Rosenzweig
This survey of controllers of companies subject to FAS 33, “Financial Reporting and Changing Prices,” shows that most are not using the data internally, contrary to assertions by other research studies. There are, however, a number of significant characteristics associated with companies that do use the information internally.

How Variable Costing Is Used in Pricing Decisions
By Thomas M. Bruegelmans, Gaile A. Hoessly, Claire P. Wolfangel, and Michael Schiff
“Strictly confidential” is usually how a company classifies information about its pricing practices. But in a recent NAA-sponsored survey, manufacturing executives revealed how and why they use the variable costing approach when making strategic pricing decisions.

Law

Caution: RICO Can Hurt You
By Chris Monical
Congress meant RICO to be used to keep organized crime from infiltrating legitimate businesses. Unfortunately, the same companies Congress set out to protect are finding themselves the target of lawsuits under this anti-racketeering act.
A Simple Way to Account for Loss Reserves for Loan Receivables 66
By William T. Geurts

Although generally accepted accounting principles require the establishment of loss reserves, they leave the method of computation to the accountants involved. When one bank senior VP and controller was asked to re-evaluate loss reserves on a loan portfolio, he found that traditional methodology did not produce the desired results, so he devised his own system—one that is relatively easy to use and that works.

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By Louis Bisgay

Here is a review of the process and accomplishments of NAA’s Committee on Management Accounting Practices.

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Companies Are Not Using FAS 33 Data

The least use of FAS 33 data was reported for ‘determining cash dividends,’ even though such data were said to be necessary to avoid excessive dividend payouts, which impair capital formation.

By Kenneth Rosenzweig

How is price-adjusted information required by FAS 33, “Financial Reporting and Changing Prices,” being used for management decision-making purposes? I mailed a questionnaire survey to the controllers of all companies in the FASB’s Statement 33 bank to find out the answers and to examine the company characteristics associated with such use.

The questionnaire was designed to find out the extent of use and reporting of FAS 33 information for internal company purposes such as management decision making, and the factors which might be associated with that use and reporting.

The controllers were asked about the extent of internal use and reporting by their companies of FAS 33 information. The respondents were asked to indicate the extent of their use and reporting on a seven-point scale from 1 or “never” to 7 or “always.” In general, very little use or reporting of FAS 33 information was revealed. See Table 1.

It was hypothesized that usage of FAS 33 information might differ among the companies according to the types of decisions for which information was required. Some decisions may be readily adaptable to the use of FAS 33 information while others may not be. However, the questionnaire responses did not reveal much difference in the extent of usage for various decision types. The decision types included adjustment of insurance coverage, capital investment decisions, product pricing and sales decisions, other purposes, make-or-buy decisions, and determining cash dividends.

It is ironic that the least usage of FAS 33 information among the decision types was reported for “determining cash dividends” because much of the literature on inflation accounting has stressed the paramount importance of inflation adjustments to avoid excessive dividend payouts and thereby impairment of original capital resulting from the use of net income based on inflated historical cost.

Another hypothesis of this study was that companies’ use of FAS 33 information would differ by organizational level. It was assumed that because FAS 33 information always would be available on a company-wide basis, the greatest use would be at the headquarters level. The use by company units would be less frequent because of an assumption that the FAS 33 information may not be assembled for those units. The questionnaire responses, however, give little support to this hypothesis.

An important prerequisite for the use of FAS 33 information by managers is the reporting of that information to them. Casey and Sandretto (1981)¹ found that 45% of the Fortune 500 com-
Firms that used price indexes were less likely to use FAS 33 data.

Companies that responded to their survey reported inflation-adjusted accounting data to managers. In contrast, my study—although it focused on FAS 33 information and measured extent of reporting in a different way—revealed very little reporting of that information to managers.

Casey and Sandretto found a materially higher rate of reporting of inflation-adjusted data to top than to operating management while this study indicated no difference in the rate of reporting between company-wide and company units. Furthermore, the results on the reporting questions in the present study have even lower scores generally than the results on the usage questions. This outcome suggests the possibility that top management of many companies may have discouraged the use of FAS 33 information within the companies by failing to work that information into the companies' internal reporting systems. Thus, lower-level managers may not have had the opportunity to use the information.

Because the Casey and Sandretto study asked about the internal reporting of all types of inflation-adjusted information including that not induced by FAS 33, the difference between the high reporting responses of that study and the low reporting responses of this study suggests that many companies are reporting to managers inflation-adjusted information other than that required by FAS 33.

Relationships among Measures of Internal Use

Even though the general level of usage and reporting of FAS 33 information was low, perhaps some companies may have reported or used FAS 33 information for one purpose while not reporting or using it for other purposes. To examine this question, Pearson correlations were calculated between the measure, Overall Usage of FAS 33 Information, and measures of internal reporting and more specific use of that information (See Table 2).

The uniformly strong and positive correlations among these measures is striking and suggests that internal reporting and use of FAS 33 information in companies is essentially a single dimension. In other words, those companies that use FAS 33 information for one purpose tend to use it for others. If FAS 33 information is used on the company-wide level, it is likely also to be used by company units. If companies reported FAS 33 information company-wide, for company units, or on a special request basis, they were more likely to use that information internally.

As noted, the questionnaire results generally indicated very little use or reporting of FAS 33 information. In order to assess the possible association of other company characteristics with the use of FAS 33 information, I focused on differences in such use. For this purpose, the dependent variable, “Overall Usage of FAS 33 Information,” was recoded into two categories: “never” and “to some extent.” “Never” included only those companies that answered “never” on the original 7-point usage scale. “To some extent” included answers 2 through 7 on the original 7-point usage scale.

From the 14 variables measuring use and reporting of FAS 33 information, the variable Overall Usage of FAS 33 Information was selected for exclusive use as a dependent variable in this analysis for three reasons. First, the dependent variables had proven to be highly correlated with one another. Second, Overall Usage seems to represent a general aspect of the dependent variables. Third, Overall Usage after recoding divides the population into two roughly equal subgroups as follows:

### Table 1
**Overall Usage of FAS 33 Information**

<table>
<thead>
<tr>
<th>Number</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Never</td>
<td>301</td>
<td>176</td>
<td>40</td>
<td>10</td>
<td>3</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Percent</td>
<td>56.6</td>
<td>33.3</td>
<td>7.5</td>
<td>1.9</td>
<td>.6</td>
<td>.2</td>
<td>.2</td>
</tr>
</tbody>
</table>

### Frequency Distribution
**Overall Usage of FASB 33 Information**

<table>
<thead>
<tr>
<th>Value</th>
<th>Number of firms responding</th>
<th>% of firms responding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Never</td>
<td>301</td>
<td>57</td>
</tr>
<tr>
<td>To some extent</td>
<td>231</td>
<td>43</td>
</tr>
<tr>
<td>Total</td>
<td>532</td>
<td>100</td>
</tr>
</tbody>
</table>

### Firm Characteristics and FAS 33

To analyze the possible relationship of company characteristics with Overall Usage of FAS 33, I focused on four general dimensions conjectured to be associated with use of FAS 33 information:
1. Commitment of management to producing and using FAS 33 information.
2. Adaptability of management to using FAS 33 information.
3. Prior experience by management with use of price-adjusted information.
4. Industry in which the company operates.

**Management Commitment.** Two aspects of the commitment of management to producing and using FAS 33 information were measured: the existence of a formal policy that management use the information and the amount of effort companies devoted to developing the information. Thus, the first hypothesis:

H1: Companies whose managements have a formal policy that FAS 33 information be used for internal purposes are likely to make greater use of that information.

It is a natural expectation that a formal policy may influence managers to use FAS 33 information and the research findings support this expectation to some extent. Because only a small proportion of the respondent companies had a formal policy (about 2%), it is difficult to predict what effect the policy would have had on usage of FAS 33 information in other companies. But apparently the formal use policy did affect usage in the companies that had such a policy.

H2: Companies that devote a greater amount of effort to the development of FAS 33 information are more likely to use that information for internal purposes.

Because carefully developed information is likely to be more useful, it is reasonable to expect that companies devoting greater effort to developing FAS 33 information are more likely to use it.

This hypothesis was tested by analyzing two variables: the number of man hours devoted by company personnel to the development of FAS 33 information and the complexity of the method used to adjust for price changes. This analysis indicates that companies using FAS 33 information devoted materially greater man hours to the development of FAS 33 information than companies that did not use the information. The “never” usage subgroup reported 664 average number of man hours, as compared to 960 average number of man hours reported by companies using FAS 33 information “to some extent.”

For the second variable, as an index of the overall complexity of adjustment methods used, the companies were asked which of four methods was the predominant one used to develop current costs for property, plant, and equipment. The methods, discussed in FAS 33, are price indexes, direct pricing, unit pricing, and functional pricing. It was assumed that the use of price indexes required considerably less effort than the use of the other three methods because those methods require a direct evaluation of the value of individual assets while price indexes can be applied to assets of different age groups without a direct evaluation. The research findings show that companies that employed price indexes were much less likely to have used FAS 33 information than companies which employed the other methods. See Table 3.

In summary, the results of the analysis of the two variables for hypothesis two suggest that a difference between companies that used FAS 33 information and those that did not was greater hours spent on development as well as the utilization of more complex methods involving the revaluation of individual assets, rather than only the minimally required methods.

**Management Adaptability.** Five aspects of the adaptability of management to producing and using FAS 33 information were assessed:

1. Perceived use of the information by external parties.
2. Perceived understanding of the information by operating management.
3. Perceived usefulness of the information for internal purposes.
4. Belief that adjustments for changing prices will continue to be required.
5. Decentralized responsibility for developing the information.
The questionnaires were mailed to the controllers of all companies on the FAS 33 Data Bank (User's Manual, 1983) as of Summer 1983. A second mailing in December 1983 was made to companies that had not responded to the first mailing. A total of 1,514 surveys were mailed out, and 544 surveys were used in the analysis, a 37% response based on the estimated total of 1,464 presumed subject to FAS 33.

The true response rate is probably somewhat higher than 37% because it is logical to assume that some of the companies that failed to respond were not subject to FAS 33. The response rate is excellent for studies of this kind and lends support to the contention that the research results reported reasonably represent the total population of companies subject to FAS 33.

The extent of use and reporting of FAS 33 information was measured on a 7-point attitudinal scale from 1, or never, to 7, or excellent for studies of this kind and lends support to the contention that the research results reported reasonably represent the total population of companies subject to FAS 33.

The research findings provide moderate support for this hypothesis. Kaplan (1984)² points out that the general subservience of internal management accounting to the external reporting function has resulted in the frequent use of inadequate methods solely because they were required for external reporting. Thus, the past unacceptability of all nonhistorical cost valuation methods for financial reporting may have inhibited the use of such methods for management decision making because only historical cost information was considered by managers to be legitimate. For some companies, ASR 190 and FAS 33 may have given more credibility to accounting data adjusted for changing prices, thereby encouraging more use of that information.

The credibility of FAS 33 information should be an important determinant of its use. Kaplan (1984)² points out that the general subservience of internal management accounting to the external reporting function has resulted in the frequent use of inadequate methods solely because they were required for external reporting. Thus, the past unacceptability of all nonhistorical cost valuation methods for financial reporting may have inhibited the use of such methods for management decision making because only historical cost information was considered by managers to be legitimate. For some companies, ASR 190 and FAS 33 may have given more credibility to accounting data adjusted for changing prices, thereby encouraging more use of that information.

H4: Companies whose operating managers understand the difference between historical cost and FAS 33 financial information are likely to have more use of FAS 33 information.

If managers do not understand the difference between historical cost and FAS 33 information, they are unlikely to demand or to use the unfamiliar FAS 33 information for their decision making.

The research findings provide moderate support for this hypothesis.

H5: Companies whose management perceives FAS 33 information to be useful for internal uses are likely to have more use of that information.

The credibility of FAS 33 information should be an important determinant of its use. Kaplan (1984)² points out that the general subservience of internal management accounting to the external reporting function has resulted in the frequent use of inadequate methods solely because they were required for external reporting. Thus, the past unacceptability of all nonhistorical cost valuation methods for financial reporting may have inhibited the use of such methods for management decision making because only historical cost information was considered by managers to be legitimate. For some companies, ASR 190 and FAS 33 may have given more credibility to accounting data adjusted for changing prices, thereby encouraging more use of that information.

This hypothesis was tested in both a positive and negative manner. On the positive side, the extent the respondents felt the information was useful for internal users was measured for the two information usage subgroups. On the negative side, the respondents were asked the extent they felt certain factors had inhibited the use of FAS 33 information by management. These factors were: information is inaccurate, information is biased, and information is not understood.

The research findings strongly support the conclusion that companies whose respondents felt FAS 33 information was "useful" are more likely to have used that information.

On the negative side, the research findings do
not support the conclusion that the extent the respondents felt FAS 33 information was inaccurate, biased, or not understood was materially associated with whether the information was used.

It is interesting that a positive belief that FAS 33 information is useful was associated with greater use but beliefs that FAS 33 information was deficient in certain respects were not associated with reduced usage. Perhaps companies that believed FAS 33 information was useful but that it had certain deficiencies, such as inaccuracy, bias, or difficulty in understanding, felt that managers could learn to compensate for these deficiencies. As a consequence, they may not restrict usage of the information by managers. Management accounting information is typically of a lower standard of precision than is financial accounting information because more knowledgeable managers are generally better able than less knowledgeable external parties to distill the essential meaning from unrefined information without being misled by its shortcomings.

H6: Companies whose managements believe that some form of required adjustments for changing prices will continue to be required for external financial statements are likely to exhibit more internal use of FAS 33 information.

If FAS 33 information is perceived as being only a passing phenomenon, then companies may invest little time in learning to use it. But if the requirement to produce FAS 33 information is permanent, then companies may see an advantage to learning how to use it. The research findings provide only slight support for this hypothesis:

H7: Companies in which the primary responsibility for the development of FAS 33 information is decentralized to lower company levels are likely to have more use of such information.

It seems logical that managers of decentralized companies that used FAS 33 information developed that information by company units.

With respect to the overall decentralization of the financial function, respondents were asked whether the company physically houses its financial records at corporate or company-wide level or at company units. Of that subgroup reporting usage of FAS 33 information, 51% said the company decentralized financial records but only 44% of the companies which did not use FAS 33 information said their financial records were decentralized. The results from both tests of the hypothesis provide only slight support for this hypothesis:

Prior Experience with Price-Adjusted Information. Companies that have a familiarity with price-adjusted information due to prior use are more accustomed to using it and therefore should be more inclined to use FAS 33 information. This hypothesis (H8) was tested with two variables: the extent

If companies felt FAS 33 data were useful, they were more likely to use such data.

| Table 3 |
| Predominant Method of Developing Current Cost for Property, Plant, and Equipment |

<table>
<thead>
<tr>
<th>Usage subgroups</th>
<th>No direct evaluation</th>
<th>Direct evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>% of 429 companies using price indexes</td>
<td>% of 38 companies using direct pricing</td>
<td>% of 24 companies using unit pricing</td>
</tr>
<tr>
<td>Never</td>
<td>59</td>
<td>53</td>
</tr>
<tr>
<td>To some extent</td>
<td>41</td>
<td>47</td>
</tr>
<tr>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>
that any form of information adjusted for changing prices was used prior to ASR 190 and whether the company was subject to ASR 190.

The research results from the first variable suggest that the extent a company used information adjusted for changing prices prior to ASR 190 is highly associated with whether that company uses FAS 33 information currently. On the second variable, the results suggest a slightly higher tendency for companies that have used FAS 33 information to have been subject to ASR 190 than companies that have not used FAS 33 information.

These results suggest the general conclusion that prior experience with price-adjusted information is an important determinant of the current use of FAS 33 information.

### Table 4
Companies in Industrial Categories Using FAS 33 Information

<table>
<thead>
<tr>
<th>Companies</th>
<th>Industrial category</th>
<th>% using FAS 33 information</th>
</tr>
</thead>
<tbody>
<tr>
<td>33</td>
<td>Retail trade</td>
<td>58</td>
</tr>
<tr>
<td>159</td>
<td>Manufacturing</td>
<td>50</td>
</tr>
<tr>
<td>135</td>
<td>Transportation, communication, electric, gas, and sanitary services</td>
<td>43</td>
</tr>
<tr>
<td>26</td>
<td>Services</td>
<td>38</td>
</tr>
<tr>
<td>77</td>
<td>Finance, insurance, and real estate</td>
<td>27</td>
</tr>
</tbody>
</table>

**Industry in which the Company Operates.** It seems plausible that companies in different industries would exhibit different levels of usage of FAS 33 information because they would tend to face different conditions with respect to such factors as technological change, competition, exposure to inflation, and so on. To test this hypothesis, the companies were asked in which of the nine general categories of the Standard Industrial Classification (Standard Industrial Classification Manual, 1972) most of their activities fell. The research results support this hypothesis (See Table 4).

Industrial categories with fewer than 25 companies were eliminated from the table because their results were likely to be more a function of the nature of the particular companies included rather than their industry. As can be seen, most of the companies were in the two categories: manufacturing; and transportation, communication, electric, gas, and sanitary services. These two categories exhibited moderate amounts of usage although they differed somewhat from one another. The most usage of 58% was reported in the retail trade category which may be due in part to that industry’s long experience with price level adjustments used in connection with the retail inventory method. The least usage (27%) was reported in the finance, insurance, and real estate category which may be due to the predominantly monetary nature of assets and liabilities of companies in that category, thus obviating the need for balance sheet adjustments.

### Why FAS 33 Was Not Used

Why have companies not generally used FAS 33 information for internal purposes? The study provides some evidence that top management commonly failed to encourage the use of the information by not working it into the internal reporting system, not adopting a policy that the information be used, and not committing resources (preparation man hours and costly adjustment methods) to developing high quality information suitable for decision making. Furthermore, the study suggests that managers in companies that encouraged use in these ways used the information to a greater extent. The failure of top management to encourage use of FAS 33 information probably accounts for the fact that operating management was found to have little understanding of it.

Another important factor was the perceived lack of use of FAS 33 information by external parties such as stockholders. This may partly account for the perceived lack of usefulness of FAS 33 information for internal users. Company managers may have felt it in their interest to use historical cost (non-FAS 33) information because external parties were perceived to be evaluating them on the basis of that information. Moreover, companies which believed external parties would use FAS 33 information more had more internal use of that information.

A further significant factor is the general lack of credibility of the information itself. It is apparent that management generally did not believe FAS 33 information was useful. This is in sharp contrast to Casey and Sandretto’s earlier conclusion that, “resistance to inflation-adjusted accounting appears to be fading.” Whether the lack of use is due to the factors stated above, the newness of the information, or its essential uselessness cannot be determined from this study. But, interestingly, the study provides some evidence that specific deficiencies of the information, such as inaccuracy, bias, or lack of understandability, could be compensated for by management in the process of using it.

Companies in different industries were found to display materially different rates of use of FAS 33 information but, surprisingly, many aspects of the complexity of company environment, which might be expected to be associated with industry, were found essentially unrelated to use of FAS 33 information. These included extent of: market competition, technology change, cost increase, company size, multiplicity of industries, and for-
eign operations. Other factors that were found un­
associated with use of FAS 33 information were
extent of outside assistance employed in develop­
ing the information and the difficulty the com­pany experienced in implementing the requirements
of FAS Statement 33.

As a test of whether the attitudes and biases of
the respondents rather than actual differences be­
tween companies may have accounted for the
findings of this study, the responses also were ana­
lyzed for various respondent characteristics, in­
cluding respondent position, seniority, formal
education, and knowledgeability. No material dif­
f erences were found for these characteristics.

Those companies that are not generally using
FAS 33 information internally must be following
one of the following practices:

1. The companies are developing their own cus­
tomized adjustments for price changes.
2. Company managers are using unadjusted infor­
mation but are allowing for the effect of price
changes in making decisions and are making
implicit mental adjustments of the unadjusted
information.
3. Company managers are using unadjusted infor­
mation and are ignoring the effect of price
changes.

This study provides no information with regard
to which of the above strategies companies are fol­
lowing but the difference between the high inter­
al inflation reporting responses of the Casey and
Sandretto study and the low FAS 33 internal re­
porting responses of this study suggests that at
least some companies are developing their own
price-adjusted information. Future research
should concentrate on determining which of the
above practices companies are following and on
remedying whatever factors are inhibiting the use
of FAS 33 information.

Only about 2% had a formal policy
mandating internal use of
FAS 33 data.

Accounting for Commodity Futures

Because of the large number of transactions a
processor may make in both the cash and futures
market, a one-to-one correlation may be difficult
to trace. The statement allows, when volume of
transactions make impractical a direct matching,
a reasonable allocation of the losses or gains on
futures contracts to those assets sold and those re­
main ing in inventory. This allocation, however,
must remain consistent.

The statement does not require futures con­
tracts to be exactly the item intended to be
hedged. Rather, the statement requires the futures
contract acting as a hedge have a high correlation
of price changes at the inception and throughout
the hedging period, that high correlation is proba­
ble, and that a clear economic relationship exists
between the prices.

An ongoing assessment of correlation of price
fluctuations between the futures contract and the
item intended to be hedged should be performed.
The statement does not quantitatively describe
what constitutes "high correlation."

Besides items mentioned previously, other com­
pany positions could affect the meeting of the
hedge criteria. These positions may include other
assets, liabilities, commitments and transactions
considered in assessment of whether a particular
item contributed to exposure.

Enterprises with decentralized risk manage­
ment activities may meet the hedging requirement
if the hedging criteria are met within a business
unit even though they are not met when the enter­
prise is considered as whole.