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March 2011

SPECIAL ISSUE **IFRS**

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Special Issue, IFRS

*The electronic professional journal of IAFEI
(International Association of Financial Executives Institutes)*

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Letter of the Editor

March 25, 2011

Dear Financial Executive,

You receive the **IAFEI Quarterly, Special Issue, IFRS**, March 2011. This is another issue of the electronic professional journal of IAFEI, the International Association of Financial Executives Institutes. This journal, other than the IAFEI Website, is the internal ongoing information tool of our association, destined to reach the desk of each financial executive, or reach him, her otherwise, at the discretion of the national IAFEI member institutes.

We are in the calendar year 3, after the world financial crisis, and ongoing changes in accounting regulations are one of the fields, where the financial crisis has a lasting impact.

Today, we present to you this special issue on **IFRS, the International Financial Reporting Standards**. It starts with a presentation by IASB/ IFRS itself on "IFRS - Present Developments and Working Program, Including Subject Convergence Between IFRS and US-GAAP", Presentation by Missis Dr. Elke König, member of the managing board of directors of IASB, presentation made in Frankfurt am Main, Germany, on February 8, 2011, before the Association of Chief Financial Officers Germany. This gives a concise summary overview of the projects and aspirations of IFRS and of the state of the Convergence Project between IFRS and US-GAAP.

Among the new IFRS regulations in the making, Hedge Accounting is key. Also key for financial executives. The IFRS proposed draft on Hedge Accounting received around 100 comments from interested parties.

We include 3 comments on the proposed new hedge accounting regulation from other professional associations which have similar objectives like IAFEI and which as well express concerns of financial executives. One is EACT, the European Association of Corporate Treasurers. See also www.eact.eu.

More comments are from ACT, The Association of Corporate Treasurers, UK, and from Japan Foreign Trade Council, Inc., Accounting & Tax Committee.

We hope that we can contribute to enhancing your knowledge on IFRS at large and on aspects of the proposed new hedge accounting regulations.

With best personal regards



Helmut Schnabel

International Financial Reporting Standards

IFRS

**Present Developments and Working Program,
Including Subject Convergence Between IFRS and**

US-GAAP

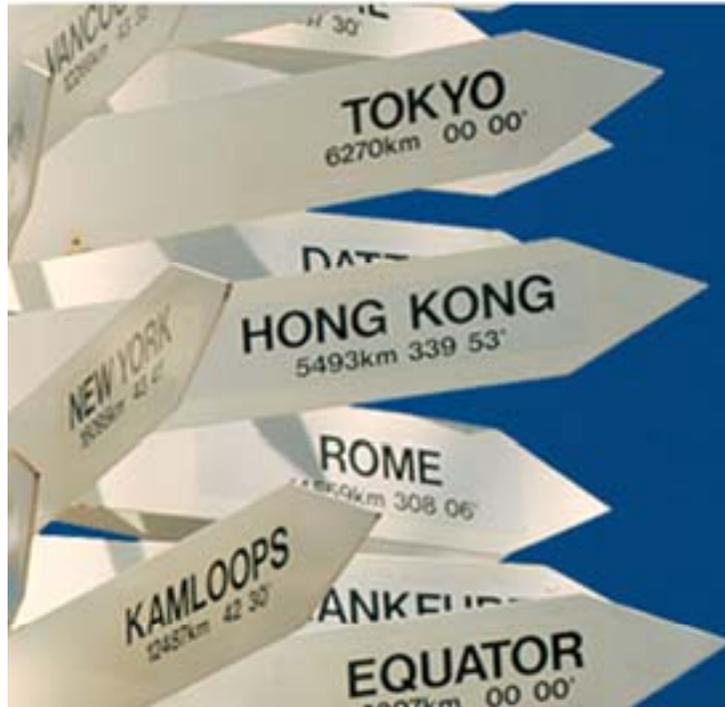
Missis Dr. Elke König, IASB Board Member

Frankfurt am Main, Germany, February 8, 2011

Presentation before the Association of Chief Financial Officers Germany

The views expressed in this presentation are those of the presenter.
Not necessarily those of the IASB or IFRS Foundation

IFRS



IFRS Aktuelle Entwicklung und Arbeitsprogramm, incl. Konvergenz zwischen IFRS und US-GAAP

Elke Koenig, IASB Board Member
Frankfurt, 8 February 2011

The views expressed in this presentation are those of the presenter,
not necessarily those of the IASB or IFRS Foundation.

Agenda

- Who we are
- The IFRS goal
- Memorandum of Understanding (MoU)
- Convergence of accounting standards
- The priority projects

IFRS Foundation

- Promotes the adoption of IFRSs, and is the oversight body of the IASB
- 22 Trustees from 14 countries
- Accountable to a Monitoring Board of public authorities

International Accounting Standards Board (IASB)

- Independent standard-setting body of the IFRS Foundation
- Currently 15 board members from 11 countries

Governance and accountability

Independence	Global accounting standards developed by an independent IASB
Due process	IASB follows a transparent and open due process that considers the views of all stakeholders
Oversight	An independent and geographically diverse body of Trustees overseeing the IASB
Accountability	Trustees themselves are publically accountable to the monitoring board of public authorities

To develop, in the public interest, **a single set of high quality**, understandable, enforceable and **globally accepted** financial reporting standards based on clearly articulated **accounting principles**.

“ We call on our international accounting bodies to redouble their efforts to achieve a single set of high quality, global accounting standards within the context of their independent standard setting process ”

G20 Pittsburgh Communiqué, 2009

How we develop standards

Consulting

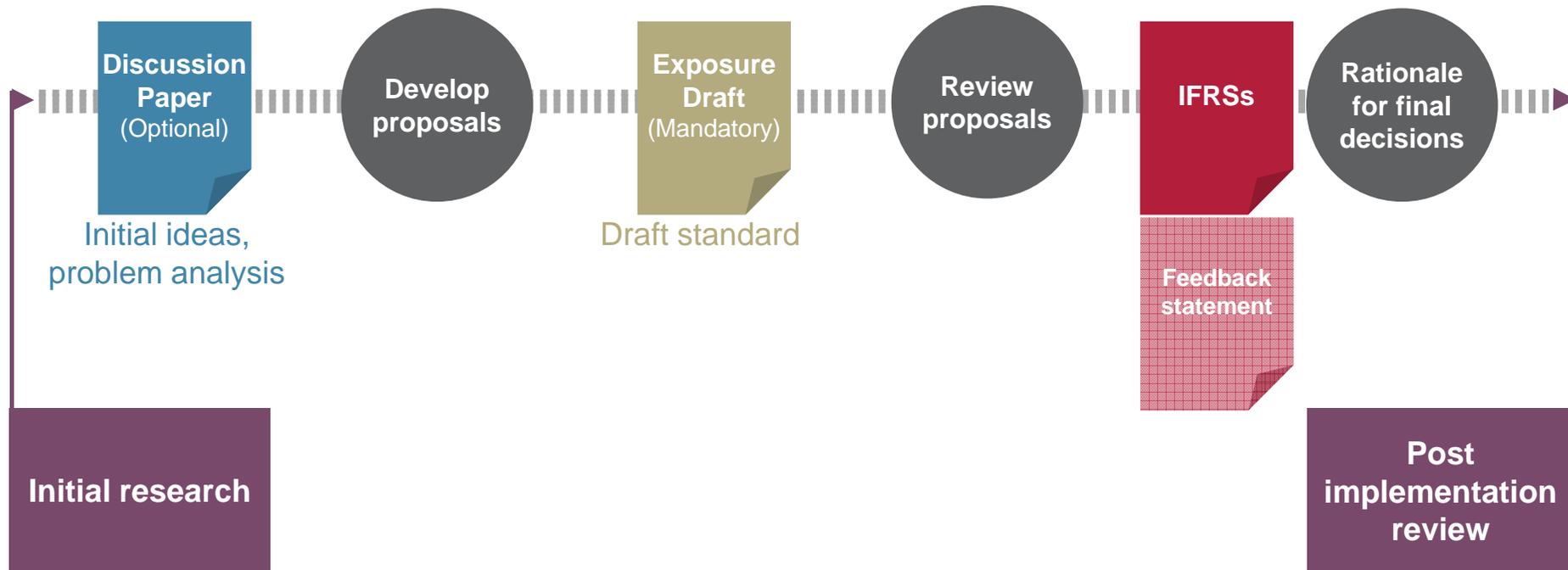
Listening

Consulting

Responding

Explaining

Extensive outreach and stakeholder input along the process



Summary of G20/FSB conclusions

- Improve fair value guidance and disclosure requirements
- Reduce complexity in reporting of financial instruments
- Strengthen accounting recognition of loan-loss provisions
- Improve accounting for off-balance sheet activities
- Redouble efforts towards global accounting standards
- Improve stakeholder engagement & representation of emerging economies

Further details on IASB response to G20 conclusions: <http://go.iasb.org/G20response>

- Since 2002, the IASB and FASB have a joint agreement to work together—Memorandum of Understanding (MoU)
- Objective: Convergence
A common set of high quality global standards
- “Standard-setters to re-double efforts to achieve convergence of global accounting standards”
- IASB and FASB intensify convergence efforts (Nov 09)

Memorandum of Understanding (MoU)

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Financial crisis projects

- Fair value measurement
- Financial instruments
- Derecognition
- Consolidation

Other projects

- Revenue recognition
- Leases
- Liability / Equity
- Financial statement presentation
- OCI
- Joint venture
- Post-employment benefits
- Investment Properties

Target date for priority projects remains June 2011

- Prioritise major projects to permit sharper focus on those areas in most urgent need for improvement in both IFRS and US GAAP
- Phasing of publication of EDs and related consultations to enable broad-based, effective stakeholder participation
- Publication of separate consultation document seeking stakeholder input about effective dates and transition methods (comment period ended 31 January 2011)

Financial crisis projects

- Financial instruments
- Fair value measurement
- Consolidation
- Derecognition

Other (MoU)

- Revenue recognition
- Leases
- Post-employment benefits

Other (Non MoU)

- Insurance contracts

Financial crisis projects

Project	Objective	Target dates
Fair Value Measurement	Develop a converged definition of fair value and common implementation guidance (incl for illiquid markets)	<ul style="list-style-type: none">Q1 2011: target for final, converged standard

This project...

- ✓ Clarifies the measurement objective
- ✓ Creates a single source of guidance
- ✓ Improves and harmonises disclosures
- ✗ Does not introduce new fair values
- ✗ Does not change the measurement objective in another IFRS

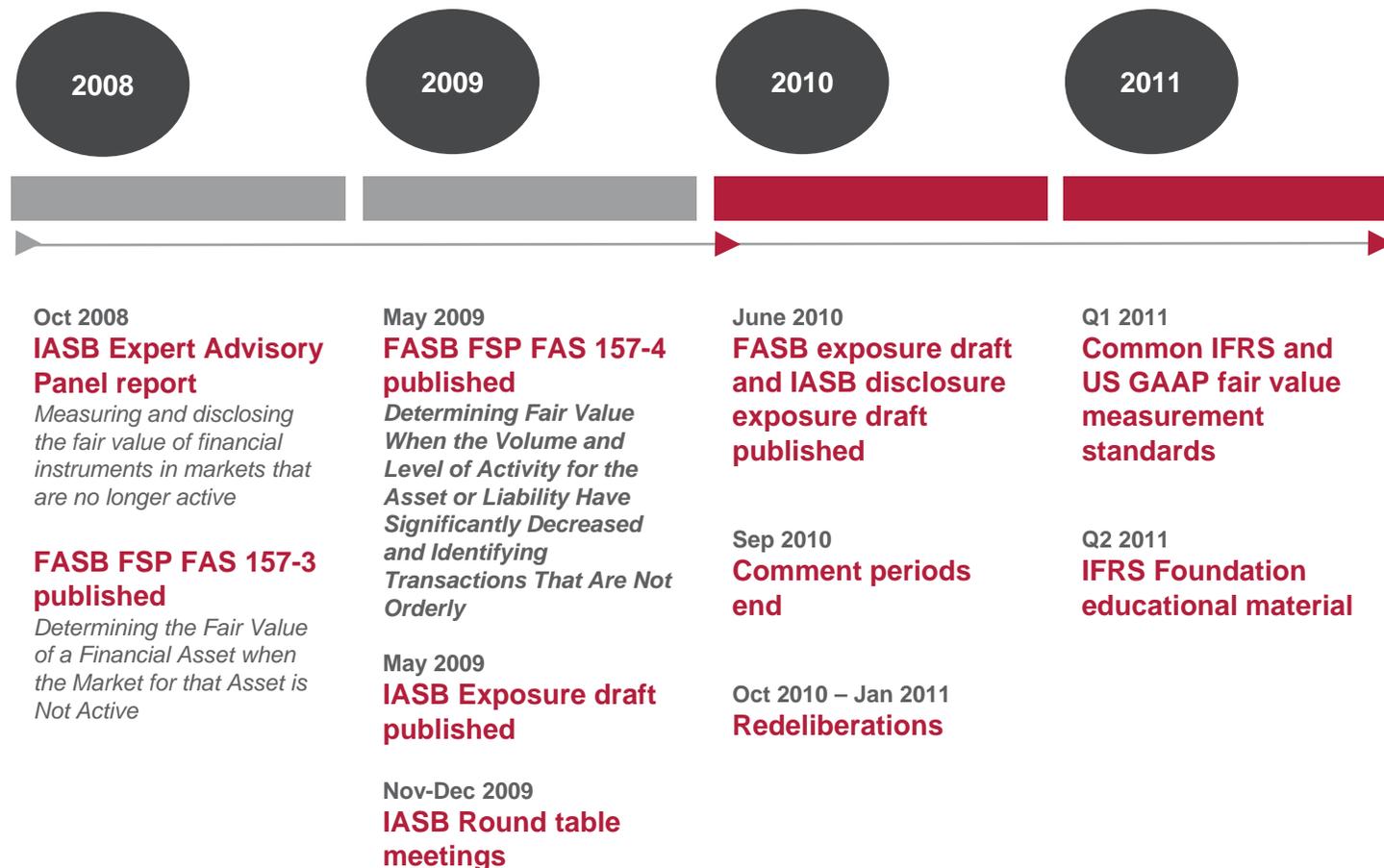
Why are we doing the project?

IFRSs	US GAAP
Existing fair value measurement guidance	Topic 820 (codified SFAS 157)
May 2009 exposure draft <i>Fair Value Measurement</i>	



Objective:
Common fair value measurement and disclosure standards

Project timeline post-crisis



Financial crisis projects

Project	Objective	Target date
Financial Instruments	Issuance of comprehensive improvements that foster international comparability of financial instruments	• Full completion: Q2 2011

Differing development timetables and imperatives resulted in differing conclusions in a number of areas.

Strategy to address differences:

- Encouraged IFRS constituents to comment on FASB proposals
- FASB round-table meetings on their comprehensive FI proposals (IASB participation) - Q4 2010
- The *Expert Advisory Panel* helped the boards to identify and address operational aspects of credit impairment models

Timetable

Phases	Exposure Draft	Finalisation
1. Classification and Measurement	Financial assets	
	Project complete	IFRS 9 published November 2009
	Financial liabilities	
	Project complete	Published October 2010
2. Amortised Cost and Impairment (redeliberations ongoing)	Published November 2009 (Comment period closed 30 June 2010) Supplementary document to ED published January 2011.	Target: 30 June 2011
3. Hedge Accounting (Board deliberations ongoing)	Published general hedge accounting ED December 2010. Portfolio hedging being discussed. Comment period closes 9 March 2011	Target: 30 June 2011

Comparison – classification and measurement

Topic	IASB Approach	FASB ED
Loans and debt securities (assets) meeting criteria	Required to be at amortised cost (subject to FVO)	May elect FV-OCI
Equity investments	FV, or if held for strategic business purposes. OCI election available	FV-NI
Financial liabilities	Retains IAS 39, except for FVO so most financial liabilities at amortised cost or bifurcated	For financial institutions most at FV and <i>many FV-NI</i> (symmetrical model)
Core deposits	Redemption amount	'Remeasurement value'

Comparison – amortised cost and impairment

Topic	IASB Approach	FASB ED
Trigger	None	None
Expected losses	Consider forward-looking information	Consider historical information adjusted for current information
Recognition of expected losses	Allocate expectation over the life of the item	Record the entire amount in the period of expectation



Supplement to the Exposure Draft *Financial Instruments: Amortised Cost and Impairment*

Issued jointly by IASB/FASB (January 2011) as a supplementary document to the IASB's original ED (November 2009);

Boards have proposed moving to an expected loss model that provides a more forward-looking approach to how credit losses are accounted for;

Boards ask for comments on the simplified model for credit impairment of open portfolios.

Comparison – hedge accounting

Topic	IASB Approach	FASB ED
Focus	Simplification	Simplification
Scope of project	Comprehensive review	Limited changes
Scope of instruments	Both financial and non-financial items	Only financial items

- ED contains proposals on the general hedge accounting model. The IASB is discussing portfolio hedging now.
- Project objective:
 - to improve the ability of investors to understand risk management activities and to assess the amounts, timing and uncertainty of future cash flows.
 - The proposals will replace the rule-based hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement* and more closely align the accounting with risk management strategies
- Hedge accounting represents the third phase of the project to replace IAS 39. This part is equally important to financial institutions and non-financial institutions.

Financial crisis projects

Project	Objective	Target dates
Asset and Liability Offsetting	Convergence on when financial assets and financial liabilities are offset	<ul style="list-style-type: none">▪ January 2011: ED publication (IASB and FASB)▪ Round tables expected 2011▪ Q2 2011: publication of standards – timing aligned with other changes to the FI standards

Financial crisis projects

Project	Objective	Target dates
Derecognition	<ul style="list-style-type: none">• Near-term priority: improving and converging US GAAP and IFRS disclosure requirements• Additional research and post-implementation review of FASB amendments to assess future of the project (2012)	<ul style="list-style-type: none">• Q4 2010: finalised improved disclosure requirements similar to US GAAP

Financial crisis projects

Project	Objective	Target date
Consolidation	<ul style="list-style-type: none">• Boards agreed that standard should include common objectives and principles• Staff draft on website	<ul style="list-style-type: none">• Full completion (IASB): Q1 2011

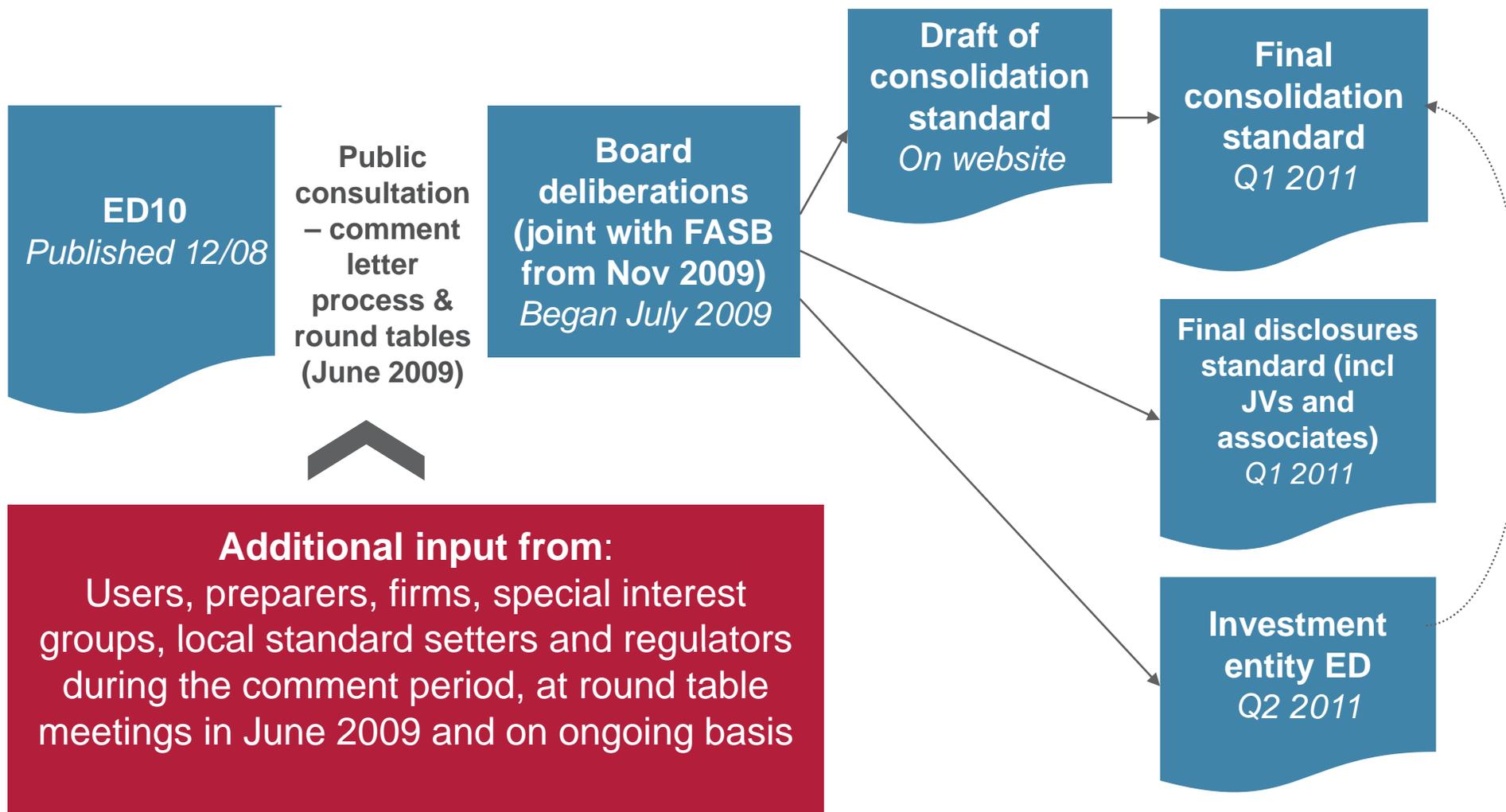
The control model – overview

Definition of control

An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

- Single consolidation model for all entities, no distinction between different types of investees when assessing control
- Consolidation based on control – ‘power so as to benefit’ model
- Controller must have some exposure to risks and rewards
Exposure is an indicator of control but does not determine control
- Power arises from contractual rights—voting rights, potential voting rights, other contractual arrangements (or a combination)

Where are we now?



Other MoU projects

Project	Objective	Target date
Revenue Recognition	Development of a single, common standard for a wide range of industries and transaction types	<ul style="list-style-type: none">• ED comments due 22/10/2010• Q4 2010: round tables• Q2 2011: joint standard

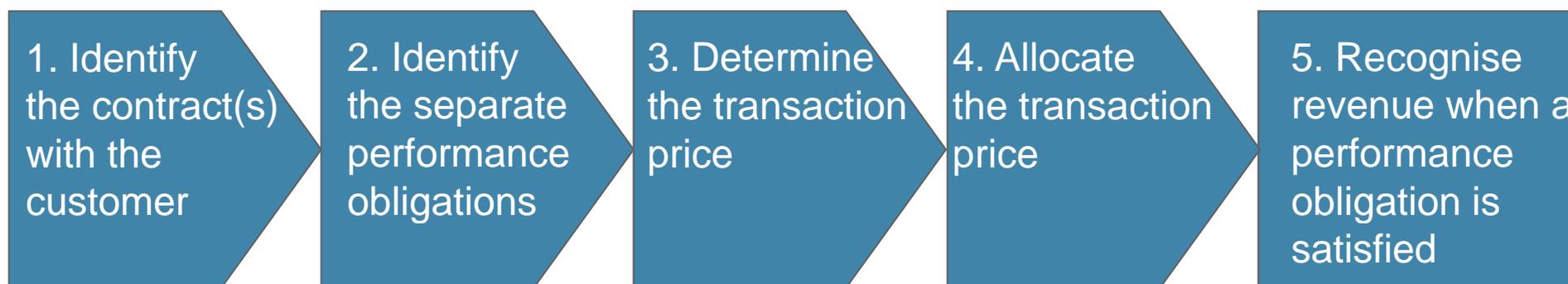
- Single model based on clear principles
- Improve accounting for contracts with customers by:
 - providing a more robust framework for addressing revenue issues
 - increasing comparability across industries and capital markets
 - providing enhanced disclosures
 - clarifying accounting for contract costs

Summary of the revenue proposals

Core principle:

Recognise revenue to depict the *transfer* of goods or services in an amount that reflects the consideration expected to be received in exchange for those goods or services

Steps to apply the core principle:



Feedback received to date

- General support for the project
- General support for the core revenue recognition principle (i.e. recognising revenue only when goods or services are transferred to a customer)
- But...

Feedback received to date (cont...)

Topic	Feedback
Control	<ul style="list-style-type: none">•Boards need to clarify the principle/indicators for determining when goods or services are transferred•Control is difficult to apply to construction and services contracts
Performance obligations	<ul style="list-style-type: none">•Boards need to clarify the principle/indicators for identifying separate performance obligations•There is a risk of breaking up some contracts (e.g. construction) more than users would find useful
Transaction price	<ul style="list-style-type: none">•The concepts would be difficult to implement (probability-weighted estimates, collectability, time value of money)
Other	<ul style="list-style-type: none">•Disclosure requirements are excessive•Full retrospective transition would be too costly•Concerns about proposals on warranties, licenses, and onerous performance obligations

Other MoU projects

Project	Objective	Target date
Leases	Development of a joint lease standard that improves lease accounting and ensures that all lease contracts are recognised on the statement of financial position	<ul style="list-style-type: none">• ED comments due 15/12/2010• Q4 2010: round tables• Q2 2011: joint standard

Why a lease project?

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- **Existing lease accounting doesn't meet users' needs**
 - Accounting depends on classification
 - Users adjust financial statements to recognise assets and liabilities arising in operating leases
- **Complexity**
 - Difficult to define dividing line between finance and operating

Feedback received to date

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- Lessees:
 - Profit and loss effects
- Lessors:
 - Performance obligation approach
 - Subsequent measurement of residual asset under derecognition approach
- General:
 - Treatment of options / contingent rentals
 - Shorter term leases
 - Services versus leases
 - Transition

Other MoU projects

Project	Objective	Target dates
Financial Instruments with Characteristics of Equity	<ul style="list-style-type: none">• Consistent classification• Exploring alternative ways forward	<ul style="list-style-type: none">• To be reconsidered after June 2011.

Other MoU projects

Project	Objective	Target dates
Financial Statement Presentation	<ul style="list-style-type: none">• Improve the usefulness of the financial information provided in an entity's financial statements• DP feedback indicated cost / benefit concerns• Additional outreach activities• Staff draft on website	<ul style="list-style-type: none">• Q3 2010: staff draft of proposed standard• Q4 2010: completion of outreach• Further discussion to be postponed to Q3 2011.

Other MoU projects

Project	Objective	Target dates
Presentation of OCI	Develop presentation standards that improve the reported items of OCI and allow easier comparability between US GAAP and IFRSs	<ul style="list-style-type: none">• Expected Q1 2011: converged and improved standard

Other MoU projects – IASB only

Project	Objective	Target dates
Post-employment Benefits – Defined Benefit Plans	<ul style="list-style-type: none">• ED issued in April 2010• Comments due Sept 2010• Currently redeliberating comments received	<ul style="list-style-type: none">• Q1 2011: IFRS expected

Other joint projects

Project	Objective	Target dates
Insurance Contracts	<ul style="list-style-type: none">• Comparable, useful information• In 2009 the boards begin discussing the project jointly – agreed on joint approach in most areas	<ul style="list-style-type: none">• IASB ED comments due 30/11/2010• FASB to issue DP comparing the IASB’s proposed model with the FASB’s tentative decisions reached to date• Q2 2011: final standard

Feedback received to date

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- Volatility being introduced
 - Interest-bearing assets
 - Amortised cost is used for assets
 - Equities carried at FV through profit or loss
 - Residual margin as a buffer?
- Discount rate: characteristics of the liability
- Risk adjustment: explicit, 3 permitted techniques
- Short-duration contracts: over-engineered
- Unbundling principle is unclear
- Transition: no residual margin on transition
- Presentation format: split views

Other joint projects

Project	Objective	Target dates
Emission Trading Schemes	<ul style="list-style-type: none">• Comprehensive guidance on the accounting• While understanding the growing importance of the project, the boards agreed that other MoU projects have a higher priority	<ul style="list-style-type: none">• Discussions to resume H2 2011.

Conceptual Framework

Documents currently being developed:

Phase A: Objective and Qualitative Characteristics	<ul style="list-style-type: none">• Final chapter published 3Q 2010
Phase B: Elements and Recognition	<ul style="list-style-type: none">• Work to recommence Q3 2011
Phase C: Measurement	<ul style="list-style-type: none">• Work to recommence Q3 2011
Phase D: Reporting Entity	<ul style="list-style-type: none">• ED was issued March 2010• Comments due 15 July 2010• Work to recommence Q3 2011

Conceptual Framework

Potential future phases:

Phase E: Presentation and disclosure	<ul style="list-style-type: none">• Not yet active
Phase F: Purpose and Status of Framework	<ul style="list-style-type: none">• Not yet active
Phase G: Applicability to Not-for-Profit Entities	<ul style="list-style-type: none">• Not yet active

Effective dates and transition

- IASB / FASB each published documents seeking views on when new financial reporting standards resulting primarily from their work to improve and achieve convergence of IFRSs and US GAAP should become effective.
- Request for views is open for comment until 31 January 2011.

- Current focus;
 - Finalising IASB response to the financial crisis
 - Completing the convergence programme
- Attention beginning to shift to post-2011 world
 - Focus moving from European / US-centric to truly global standards
 - Three new members of the IASB, including Chairman
 - Planning has begun for the post-2011 agenda
- Post 2011 agenda
 - Initiation of a the first three-yearly public consultation before June 2011
 - Formal consultation with IFRS Advisory Council
 - Some potential items may include deferred and research projects
 - Overhaul / completion of conceptual framework

We will be listening to all stakeholders before setting the agenda

- Trustees seeking input on future strategy of the organisation;
 - **Mission:** How to define the public interest to which the organisation is committed?
 - **Governance:** How should the organisation best balance independence with accountability?
 - **Process:** How to ensure standards are high quality, meet the requirements of capital markets and implemented consistently?
 - **Financing:** how should the organisation best ensure forms of financing that permit it to operate effectively and efficiently?
- Responses by 24 February 2011

Questions or comments?

Expressions of individual views by members of the IASB and its staff are encouraged. The views expressed in this presentation are those of the presenter. Official positions of the IASB on accounting matters are determined only after extensive due process and deliberation.



PRESS RELEASE

9 December 2010

IASB proposes improvements to hedge accounting

The International Accounting Standards Board (IASB) today published for public comment an exposure draft on the accounting for hedging activities. The exposure draft proposes requirements that will enable companies to reflect their risk management activities better in their financial statements, and, in turn, help investors to understand the effect of those activities on future cash flows.

The proposed model is principle-based, and will more closely align hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures. The proposals also include enhanced presentation and new disclosure requirements.

Commenting on the proposals, Sir David Tweedie, Chairman of the IASB, said:

These proposals sweep away the existing rule-based, complex and inflexible hedge accounting requirements and replace them with a simple, principle-based approach.

The result, if adopted, will be a much simpler model that better reflects risk management practices whilst providing more useful information to investors.

A summary of the proposals (IASB Snapshot) is available to download from the Snapshot library at <http://www.ifrs.org/High+level+summaries/snapshot+library.htm>.

The exposure draft builds on proposals contained in the IASB's discussion paper *Reducing Complexity when Reporting Financial Instruments* published in March 2008. The exposure draft forms part of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*, and when its proposals are confirmed they will be incorporated into IFRS 9 *Financial Instruments*.

The exposure draft *Hedge Accounting* is open for comment until 9 March 2011 and can be accessed via the 'Comment on a proposal' section of www.ifrs.org. During the consultation period, the IASB will undertake further outreach to seek views on the proposals. The IASB will redeliberate the proposals with a view to completing the new hedge accounting requirements in the first half of 2011. In addition to the general hedge accounting proposals in the exposure draft, the IASB is continuing to discuss portfolio macro hedge accounting.

The IASB is the independent standard-setting body of the IFRS Foundation.

The IFRS Foundation is a not-for-profit corporation under the General Corporation Law of the State of Delaware, United States of America
Registered Office: 1209 Orange Street | Wilmington | New Castle County | Delaware 19801 | United States of America; Company No.: FC023235.

To find out more, visit the IFRS 9 *Financial Instruments* section of the IASB website via <http://go.ifrs.org/IFRS 9 Financial Instruments>.

An interactive webcast on the proposals will be held at 9.00am (UK time) on Monday, 13 December, and repeated at 3.00pm (UK time) on the same day. To register, please visit go to <http://go.ifrs.org/hedge accounting webcast>.

End

Notes to editors

About IFRS 9 *Financial Instruments*

Responding to the requests from the G20 and others to address urgent issues whilst also undertaking a comprehensive overhaul of the accounting for financial instruments, the IASB has been publishing IFRS 9 *Financial Instruments* in phases. Phase one, which was completed in October 2010, addressed classification and measurement requirements for financial instruments. The second and third phases address the accounting for the impairment of financial assets and hedge accounting. The IASB aims to complete those phases in 2011, and thus complete its project to replace IAS 39.

Press enquiries:

Mark Byatt, Director of Communications, IFRS Foundation
Telephone: +44 (0)20 7246 6472
Email: mbyatt@ifrs.org

Gillian Bishop, Communications Manager, IFRS Foundation
Telephone: +44 (0)20 7246 6463
Email: gbishop@ifrs.org

Technical enquiries:

Sue Lloyd, Director of Capital Markets, IASB
Telephone: +44 (0)20 7246 6454
Email: slloyd@ifrs.org

Martin Friedhoff, Technical Principal, IASB
Telephone: +44 (0)20 7246 6902
Email: mfriedhoff@ifrs.org

About the IASB

The IASB was established in 2001 and is the standard-setting body of the IFRS Foundation, an independent, private sector, not-for-profit organisation. The IASB is committed to developing, in the public interest, a single set of high quality global accounting standards that provide high quality transparent and comparable information in general purpose financial statements. In pursuit of this objective the IASB conducts extensive public consultations and seeks the co-operation of international and national bodies around the world. The IASB currently has 15 full-time members drawn from 11 countries and a variety of professional backgrounds. By 2012 the Board will be expanded to 16 members. Board members are appointed by and accountable to the Trustees of the IFRS Foundation, who are required to select the best available combination of technical expertise and diversity of international business and market experience. In their work the Trustees are accountable to a Monitoring Board of public authorities.



The European Association of Corporate Treasurers

Comment letter in response to IASB ED/2010/13: Hedge Accounting

European Association of Corporate Treasurers (EACT)

The EACT is a grouping of 20 national associations representing treasury and finance professionals in 19 European countries. We bring together in excess of 8,500 members representing approximately 5,000 companies located in Europe. We comment to the European authorities, national governments, regulators and standard-setters on issues faced by treasury and finance professionals across Europe. We seek to encourage the profession of treasury, corporate finance and risk management, promoting the value of treasury skills through best practice and education.

Our contact details are provided on the final page of this document.

EACT response

1. General comment

We welcome the IASB's project to improve and simplify IAS 39 and undertake a fundamental review of the standard. IAS 39 has widely been regarded as unduly complex and often leading to unrepresentative accounting outcomes. We believe that hedging is an economic activity and that hedge accounting should be designed to reflect the economic reality of risk management. IAS 39 hedging is rules based whereas IFRS is, in general, principles based.

Many of the rules related to hedge accounting were drafted to prevent abuse. We believe that these strict anti-abuse provisions encourage constituents to structure transactions to avoid running afoul of these rules. As a result, the treasury community has experienced a worrying trend in recent years, of risk management activities often being structured sub-optimally to fit within the strict guidelines of IAS 39. In addition, compliance requires significant time and effort that is disproportionate to the benefit obtained. Although we recognize that there have to be controls over the application of hedge accounting, we believe that this control would best be accomplished through use of professional judgment rather than rules based standards.

Notwithstanding the comments above EACT agrees with the objectives of the Board. It is felt by our members that IASB had taken the right approach in not starting 'with a blank page' but focusing on patching up the current framework. In general the changes proposed by the Board are welcomed, as they bring accounting closer to the risk management strategy of non-financial companies and simplify hedge accounting rules.

EACT hopes that the IASB will consider that the concerns expressed in this comment letter are essential, to allow the hedge accounting part of the new IFRS 9 standard to be better tailored to meet the requirements of practical financial risk management approaches and strategies of non-financial companies.

We discuss below particular areas where EACT wants to make comment and which should be changed in the interest of reducing complexity.

2. Qualifying for hedge accounting

a. Voluntary de-designation prohibited

EACT does not agree with the proposed prohibition on de-designation, for the following reasons:

- This is not in line with current risk management market practice, for example when a company enters into a cash flow hedge for forecasted sales in foreign currency. As the aim of risk management strategy is to protect its cash flows, the hedging horizon would be until settlement of the invoice. However, hedge accounting would only be applied up to the moment the sales invoice becomes an on-balance sheet item, after which the company obtains a natural offset in the income statement through the revaluation of both hedged item and hedging instrument. Please refer to Appendix 1 where an example is illustrated.
- EACT feels that this rule could be circumvented by applying the strategy of taking an opposite derivative position, and applying hedge accounting on the whole structure. Hence we do not see the benefit of this prohibition.
- EACT members have difficulty in applying this concept to situations of net investment hedges. Voluntary de-designation should be permissible for net investment hedges if a partial/total reduction of hedge occurs. If a corporate has an investment in a company and, for whatever reason, the amount of the investment is partially or totally reduced, then the hedge should be de-designated and unwound in order to avoid profit and loss effects. Furthermore, if the risk management objectives change and the company decides to reduce the amount of net investment hedges in place, these hedges should be de-designated and then unwound.
- There is a general consensus among our members that de-designation flexibility is needed and required to more closely align hedge accounting to the risk management strategy. It is also important to state that de-designation is allowed when changes in the risk management policies take place, therefore reinforcing the idea that voluntary de-designation is closely tied to risk management, which is dynamic and therefore should be permitted.

b. Mandatory rebalancing

EACT is pleased that the arbitrary 80-125% rule is to be removed; however it is felt that it is unnecessary to introduce mandatory rebalancing, for the following reasons:

- This represents a lack of confidence in risk management, whereas the risk management strategy and results need to be disclosed in the financial statements and defended towards auditors and investors
- Rebalancing is the core responsibility of risk management, which is a serious profession with appropriate standards and controls in place
- This will not be equal for every company, as each has to deal with different circumstances
- If a company were to rebalance, this would mean in practice a need to recognize ineffectiveness into profit and loss, which would yield the same result
- If a company were to set the optimal ratio incorrectly, the resulting ineffectiveness would in any event need to be recorded in the income statement

EACT believes that rather than reduce complexity this would in fact increase it. For example, how to define the optimal ratio? Different risk managers will reach different conclusions, as this is not a matter of fact but rather based on interpretation and differing models or views of the market. Another example would be how to deal with a gradual change in hedging ratio. Such changes in the hedging ratio can imply de-designation when the hedge has to be adjusted to a lower ratio, whereas when the hedge has to be increased this can be done entering into a new hedge.

c. Calculation of ineffectiveness using discounted spot

In general EACT agrees with the need to include time value in the ineffectiveness calculations; however this should not be made mandatory. We consider that this would give rise to unnecessary ineffectiveness in some circumstances e.g. when using short term rolling forward contracts, whereby the intent is to hedge the undiscounted spot component but not the interest component. In currencies with very high interest rates (for example emerging markets currencies), the ineffectiveness amount tends to be larger. An example in Appendix 2 illustrates this point. Therefore, we would propose to allow the use of undiscounted spot in some circumstances.

3. Hedge items – components of non-financial items

a. Separately identifiable and reliably measurable

EACT supports the proposed changes, but at the same time believes that the Board should elaborate further the concept of separately identifiable and reliably measurable, setting a range of examples in order to avoid arbitrariness. In terms of the eligibility of the implicit risk, it is proposed that each company should be able to decide whether an implicit risk is an eligible hedge item, based on the link/correlation and overall risk management strategy; however it should also be required to provide sufficient disclosures on this in the notes to the financial statements, and therefore enable users to understand the nature of the strategy.

Hence in cases where it is difficult to measure the implicit component, we would make the assumption that the hedge relationship would be 100% effective, and that to be consistent with the risk management strategy, the hedging result should be taken when the hedged item affects the income statement. This simple and pragmatic approach is proposed

because it is difficult to imagine a way to determine any ineffectiveness on the hedged implicit risk.

b. Designation of a layer component of the nominal amount

We support the IABS's proposed changes.

c. Designated component must be less than or equal to the total cash flows

EACT disagrees with this restriction. We believe that if the components are present, they should be entitled to the same hedging possibilities. In instances where a commodity is quoted or priced at a discount to the futures price, the exchange-traded amount should still qualify as a component that can be hedged.

4. Hedge items – groups and net positions

a. Income statement presentation

EACT does not agree with the proposed changes, as it believes this leads to misleading/meaningless numbers in the income statement as it represents only part of the profit and loss impact of those items being hedge accounted. We would propose to gross up the net resultant profit and loss impact in a manner similar to creating synthetic derivatives. This would be the only way to truly reflect the risk management rationale behind hedging sales and purchases on a net basis.

This approach furthermore ensures conceptual alignment with the hedging of a gross group of dissimilar items (which also includes opposite movements), where here it would be acceptable to gross up the result. For example, if we use a FTSE100 index option to hedge a portfolio of FTSE100 shares, which perfectly replicate the index, the portfolio shares will offset the option perfectly, although the individual shares in this portfolio might move in different directions. What should be recycled when one of the shares is sold? In our opinion, if you do not gross up the net result on the index option (i.e. allocation of hedging gains and losses to individual share according to how much they moved by) then you do not know how much to release when a single share is sold.

IASB has not addressed the mechanics of how this would work for groups of dissimilar items. However IASB is proposing rules to constrain this (same period and non-grossing up of gains and losses) in relation to pure net exposures. We do not see why net positions would be treated more restrictively than portfolios of dissimilar items, which include some element of offsetting.

b. Same period

We disagree with the proposed changes, as from a risk management perspective treasurers generally hedge the cash flow in a defined period and not the profit and loss. Given the overall objective to align hedge accounting with the risk management strategy the ability to net hedge account even where items impact the profit and loss in different reporting periods should not be prohibited. Any restriction in periods would create a restriction on hedge accounting that in no way reflects the risk management strategy. Please see Appendix 3 for a worked example of designating net positions in a hedging relationship where items impact the profit and loss account in different reporting periods.

To conclude, EACT welcomes the proposed changes, however it believes they do not go far enough as most cases of net position hedging are related to the hedging of sales and purchases in foreign currency, which typically does not occur in the same month.

5. Hedging with options

It is agreed that these are positive changes, as they bring IFRS closer to US GAAP. EACT agrees with the fact that the premium has to be reflected in the underlying whether it is sales, purchases or interest. For period-related hedges, it was felt that the correct period for amortization should be the entire life of the underlying taking into account amortizing schedules. In terms of transition period, EACT would encourage more clarity (e.g. to amortize the OCI over the lifespan of the underlying).

6. Presentation and disclosures

a. Fair value hedge model

We do not see the benefits of grossing up OCI, for the following reasons:

- In spite of helpfulness of more comprehensive disclosures, it is not useful for investors to have this information on the face of the balance sheet
- This approach adds unnecessary complexity

b. Cash flow hedge model – mandatory basis adjustment

EACT does not agree that this should be made mandatory. Mainly for operational reasons it would be preferable to allow the current flexibility of choosing whether to make the basis adjustment or not (e.g. inventory systems are not designed to deal with this adjustment).

c. Cash flow hedge model – recycling out of equity

This is not considered a useful change, as it adds unnecessary complexity. Also, cash flow results should be considered as a higher or lower cost of the hedged item. According to our members, the perception is that equity is meant for transactions with owners and should hence not be mixed.

d. Disclosures

There is a general concern regarding the disclosure of commercially sensitive information. This issue is particularly prevalent in corporations reporting under IFRS and where key competitors are private companies and hence not required to provide detailed numerical of hedges in place impacting future periods and average hedged rates. Disclosing quantitative hedged amounts and rates is an area of commercial sensibility. We do not think such disclosures are compatible with the fiduciary duty of Directors to protect shareholder's interests. Many EACT members believe such disclosures, including those on risk exposures, whether hedged or not, should be part of a broader project on risk management in more general terms, rather than financial risks only. EACT representatives would like to offer to work together with investors and the IASB to come to a suitable solution to help disclose the appropriate level of detail on the risks, risk exposures and risk management.

Appendices:

Appendix 1

Cash Flow Hedge Example to illustrate the need for voluntary de-designation

- Each Business Line sets up a purchase budget with a predetermined FX rate dictated by Risk Management. This implies an assumed risk between today (T0) and the different Accounting Record dates (T2) that impacts the CAPEX figure. The Financial Department assumes the risk from the moment the purchase is accounted for. Between T2 and T3, Foreign Exchange changes are financial income/expense. (See Figure 1)
- **Financial Instruments and Accounting Consideration**
 - **Forward**
 - Using forwards implies locking a fixed foreign exchange rate.
 - **Accounting Issues**
 - Forward: no restriction to obtain hedge accounting under IFRS. Although under current proposal voluntary de-designation could cause problems.

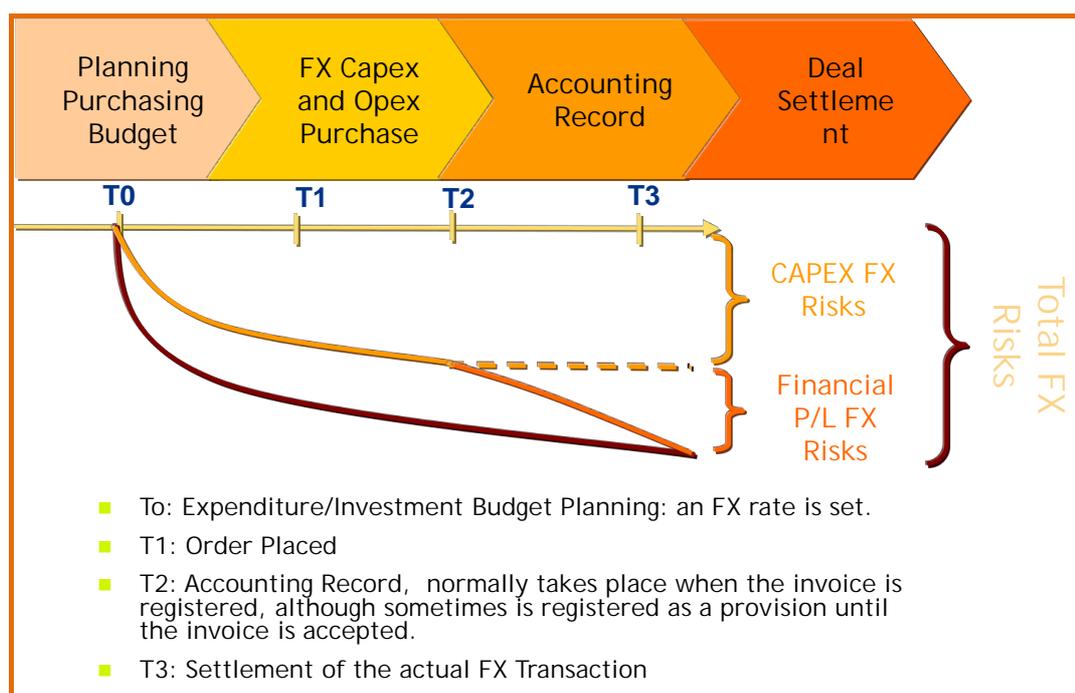


Figure 1.

- **How is De-Designation Applied**
- Suppose that in T1 a pre-hedge of an invoice was done. For the accounting record, we will designate it like a cash flow hedge of a “highly probable cash flow” using the Forward Method. Between T1 and T2 the FWD Market Value change is registered in Reserves. The invoice is not registered yet so no effect at all.

- In T2 (Accounting Record of Invoice), the up to date value registered in Reserves goes CAPEX Spending (AR/AP) and from that date on the forward is de-designated from CFH to MTM creating foreign exchange differences. The invoice also starts creating foreign exchange differences. Between T2 and T3, we have an account payable/receivable in the opposite sense that compensates the FX changes due to the Forward.

Appendix 2

Hedging foreign currencies with high interest rates:

BRAZIL			
Actual Scenario			
3m Roll			
Amount MM BRL	100	100	AMOUNT OF HEDGE
Roll 1			
Amount MM BRL	100	100	AMOUNT OF HEDGE
Inefficiency Amount	0		
Hedge Rebalancing		0	
Hedged Item	100	100	AMOUNT OF HEDGE
Spot to Spot hedged Forwrd Points to MTM			
BRAZIL			
Discounted Spot			
3m Roll			
Amount MM BRL	100	100	AMOUNT OF HEDGE
Roll 1			
Amount MM BRL	98	100	AMOUNT OF HEDGE
Inefficiency Amount	2		
Hedge Rebalancing		-2	
Hedged Item	98	98	AMOUNT OF HEDGE
Spot to Spot Unhedged Hedge Rebalancing needed Forwrd Points to MTM			
USD			
Discounted Spot			
3m Roll			
Amount MM BRL	100	100	AMOUNT OF HEDGE
Roll 1			
Amount MM BRL	100	100	AMOUNT OF HEDGE
Inefficiency Amount	0		
Hedge Rebalancing		0	
Hedged Item	99.94	99.94	AMOUNT OF HEDGE
Spot to Spot Unhedged Hedge Rebalancing needed Forwrd Points to MTM			

Appendix 3

A worked example of designating net positions in a hedging relationship where items impact the profit and loss account in different reporting periods

NET HEDGING DESIGNATION EXAMPLE

From an economic perspective the Treasurer is hedging net USD cash inflows of 50 for the month of March (stated in GBP equivalent for simplicity)

For hedge accounting purposes he/she has designated the net 50 inflow as the hedged item i.e. Hedging the net of sales cash inflows and purchase outflows for the month of March

Hence hedge accounting is aligned to the risk management policy

The example below shows that even though the net items impact the profit and loss account in different periods, it is possible to hedge account for these items by grossing up the movements through OCI for the individual components i.e. Sales and purchases.

Assumptions:

- 1 60 day credit terms on sales
- 2 30 day credit terms on purchases
- 3 stock turnover = 0mths i.e. Stock is sold in the month of purchase
- 4 100% effective hedge i.e. Cash flows occur when forecast to
- 5 FX policy is to hedge 100% forecast cash flow on a 3 month rolling basis
- 6 hedge = Fwd FX contract (sell USD, buy GBP) bought in Dec, maturing in Mar

Forecast cash flows:	(all in GBP equivalent)				
	Dec	Jan	Feb	Mar	Apr
USD sales		100	90	85	100
USD purchases		40	40	35	30
Net forecast cash flow		60	50	50	70
Hedges in place as at December		60	50	50	0

For March forecast cash flows

Sales impact profit and loss account in January (60 days credit terms)

				DR	CR
31-Jan	DR	Accounts Receivable		85	
	CR	Sales			85

Purchases impact profit and loss account in February (30 days credit terms)

				DR	CR
28-Feb	DR	Purchases		35	
	CR	Accounts Payable			35

Accounting for derivative fair value of derivative is:	Change in FV of derivative	Grossed up for Sales	Grossed up for Purchases
31-Jan	2	3.4	-1.4
28-Feb	1	1.7	-0.7
31-Mar	2	3.4	-1.4
Accumulated fair value	5		

				DR	CR
31-Jan	DR	Derivative (balance sheet)		2	
	CR	OCI			2
Recording change in FV of derivative in Jan					

				DR	CR
31-Jan	DR	OCI		3.4	
	CR	Sales - FX gain			3.4
De-designation of cash flow hedge for sales component as sales have occurred					
NB. Purchases have not yet impacted P&L in Jan so no de-designation entry					

				DR	CR
28-Feb	DR	Derivative (balance sheet)		1	
	DR	OCI		0.7	
	CR	FX gain (P&L)			1.7
Recording change in FV of derivative in Feb.					
FX gain on sales component directly to P&L as hedge de-designated in Jan					

				DR	CR
28-Feb	DR	Purchases - FX loss		2.1	
	CR	OCI			2.1
De-designation of cash flow hedge for purchases component as purchases have occurred					
This removes the entire OCI balance relating to purchases i.e. 1.4 in Jan and 0.7 in Feb					

			DR	CR
31-Mar	DR	Derivative (balance sheet)	2	
	CR	FX gain (P&L)		2
		Recording change in FV of derivative in Mar		
		No longer hedge accounting for sales and purchases so all goes to P&L		
			DR	CR
31-Mar	DR	Cash - GBP	55	
	CR	Cash - USD		50
	CR	Derivative (balance sheet)		5
		Maturity of derivative		

The European Association of Corporate Treasurers

Registered Office:	20 rue d' ATHENES 75442 PARIS Cedex 09
EACT Chairman:	Richard Raeburn richard.j.raeburn@gmail.com +44 7802 966 665
EACT board member – accounting standards:	Francois Masquelier francois.masquelier@rtlgroup.com + 35 2 42 142 2121
Website:	www.eact.eu

PRESS RELEASE
The Association of Corporate Treasurers

IASB does not go far enough

4 March 2011, London

ACT submit comments on hedge accounting component of draft IFRS 9 to the IASB

The ACT welcomes the IASB's attempt in the Hedge Accounting exposure draft to ensure the accounting disclosures reflect the economic realities more faithfully. Nonetheless we regret that it is still over complicated and too rule-based.

ACT Chief Executive Stuart Siddall commented that

"Overall it is definitely a step in the right direction in attempting to align accounting with the economic activity of hedging. It is still unnecessarily complicated and in some instances the accounting may drive the risk management activities instead of the other way around.

"Some disclosure requirements are excessive and commercially too sensitive and others could positively mislead users of the financial statements."

Over-elaborate rules, not allowing the principles to be applied sensibly, need reconsideration. For example the detailed rules mean that many companies will be unable to net hedge account for foreign denominated sales and purchases.

Whilst the disclosure requirements are seeking to be helpful to the investor community there is a danger that on their own they are misleading. Users of financial statements need information to understand the total picture of financial risks that the company is exposed to, what has been hedged and of those, what has been hedge accounted.

This exposure draft focuses on those items that have been hedge accounted. The items that have been hedged but have not been hedge accounted for, or those not hedged at all, can far outweigh the size and impact of those that have been hedge accounted. We believe disclosing only part of the picture is positively misleading.

The requirements to disclose forward projections of sales of products and services and purchases of commodities and material, together with details of derivatives hedging these (including hedge amounts and hedged rates) has sparked anxiety amongst treasurers. Companies are not happy about 'giving the game away' to competitors, particularly if the competitors don't themselves have to report under International Financial Reporting Standards (IFRS) or their exposures are lost among others in consolidated group financial statements.

The full submission to the IASB is available at www.treasurers.org/ifrs9/actresponse.

----- Ends -----

For further information please contact:

Stuart Siddall, Chief Executive, ACT

T: +44 (0)20 7847 2542 (direct line) or +44 (0)20 7847 2540 (switchboard)

E: ssiddall@treasurers.org

Michelle Price, Technical Officer, ACT

T: +44 (0)20 7847 2578 (direct line) or +44 (0)20 7847 2540 (switchboard)

E: mprice@treasurers.org

John Grout, Policy and Technical Director, ACT

T: +44 (0)20 7847 2575 (direct line) or +44 (0)20 7847 2540 (switchboard)

E: jgrout@treasurers.org

Should editors wish to commission an article from the ACT, please contact Sharon Newell, Head of Marketing and Communications at snewell@treasurers.org.

A summary of key points in the ACT's comments to the IASB include:

- Positives:
 - Effectiveness testing - 80-125% bright line has now been removed
 - Hedging with options - time value can be deferred in OCI so less profit and loss volatility

- Can now designate a layer of the nominal amount of an item (e.g. debt) as a hedged item. Previously the treasurer had to specify which specific debt instrument was being hedge accounted which was inflexible if the debt was restructured
 - A risk component (e.g. commodity risk) can now be designated as a hedged item. Under IAS 39 only foreign exchange risk could be separated from non-financial items
 - Derivatives can now be hedged items when combined with a non-derivative
- Negatives:
 - Hedge accounting a net position is now allowed, however not for the typical corporate situation of hedging foreign denominated sales and purchase cashflows (because they don't impact the profit and loss in the same reporting period). The revision does not go far enough and we are recommending that sales and purchases should be allowed with the adjustments in and out of OCI to be done on a gross basis.
 - Rebalancing of hedge relationships (an adjustment to a continuing hedge relationship, rather than a de-designation and new hedge relationship under IAS 39) is mandatory. We agree with the concept of rebalancing as it does not require a new hedge relationship with the resultant documentation, hedge effectiveness etc. However we do not believe it should be mandatory but at the entity's discretion. The treasurer deciding to rebalance the hedge because of external changes in the market should be the driver not the other way around
 - Voluntary de-designation of hedge relationships is not permitted unless risk management objectives have changed. We disagree and think there should be some flexibility
 - Fair value hedge accounting adjustments are to be presented as a separate line item in the balance sheet. This could add numerous complicating lines to a corporate's balance sheet and we believe the detail should be in the notes to the accounts
 - Gains or losses arising from a net position hedge will be shown as a separate line item in the income statement. We believe this number will be misleading to readers of the accounts as they will think it is the entire FX (as an example) impact, rather than only those items which have been hedge accounted on a net basis. Referring to the net hedging point above we believe the adjustments should be made on a gross basis to the underlying items (e.g. sales and purchases) which is consistent with the accounting treatment for items hedge accounted on a gross basis
 - All fair value movements on hedged items and hedging instruments will be taken to OCI before being taken to profit and loss (previously this was only for cash flow hedges). This adds unnecessary complexity
 - Basis adjustment (e.g. from OCI to stock) was a policy choice but is now mandatory. From an operational perspective this will difficult to incorporate as stock systems were not designed to cope with derivative gains/losses

NOTES TO EDITORS:

1. The International Accounting Standards Board (IASB) issued an exposure draft on 9 December 2010 that proposes to overhaul the current requirements for hedge accounting. This is the third phase of the project to replace IAS 39 Financial Instruments: Recognition and Measurement (effective date 1 January 2001). Refer to www.ifrs.org/NR/rdonlyres/05439229-8491-4A70-BF4A-714FEA872CAD/0/EDFIHedgeAcctDec10.pdf.
2. The current hedge accounting rules in IAS 39 have often been criticised for not allowing or for making it very costly to hedge account common risk management practices
3. A non-financial company's main business is in providing goods and services and not financial price risk. Many lay off this risk through hedging with derivative instruments, mostly contracted with financial institutions

About the ACT

The Association of Corporate Treasurers (ACT) is the leading professional body for international treasury providing the widest scope of benchmark qualifications for those working in treasury, risk and corporate finance. We define standards, promote best practice and support continuing professional development. We are the voice of corporate treasury representing the interests of our members. ACT provides a wide range of professional development and networking opportunities centred around:

- professional qualifications and training courses
- conferences, briefings and thought-leadership events
- publications, technical updates, guidance and dialogue.

For further information visit www.treasurers.org

The Association of Corporate Treasurers

Comments in response to
Hedge Accounting Exposure Draft ED/2010/13
International Accounting Standards Board,
December 2010

March 2011

The Association of Corporate Treasurers (ACT)

The ACT is a professional body for those working in corporate treasury, risk and corporate finance. Further information is provided at the back of these comments and on our website www.treasurers.org.

Contact details are also at the back of these comments.

We canvas the opinion of our members through seminars and conferences, our monthly e-newsletter to members and others, *The Treasurer magazine*, topic-specific working groups and our Policy and Technical Committee.

General

The ACT welcomes the opportunity to comment on this matter.

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The ACT agrees with the overall objectives of the December 2010 IFRS 9 Hedge Accounting Exposure Draft (ED), being to align hedge accounting more closely with the risk management activities, establish a more objective-based approach to hedge accounting, and address inconsistencies and weaknesses in the current hedge accounting standard.

We agree with the IASB's approach of moving from what was a very „rules based“ accounting standard to a more „principles based“ standard. However we don't believe the IASB has gone far enough in this matter and has included some rules to patch up issues that exist in specific industries or sectors under IAS 39 but are not „fit for all“. This results in unnecessary complexity and, in some instances, the accounting driving the risk management activities instead of the other way around. Proposals to which this comment applies include hedge accounting for net positions, mandatory rebalancing of hedge relationships, prohibition of voluntary de-designation of hedge relationships and the accounting mechanics for fair value hedges.

We believe the disclosure requirements are seeking to be helpful to the investor community. However there is a danger that as proposed, on their own they are positively misleading. Users of accounts need information to understand the total picture of financial risks that the company is exposed to, what has been hedged and, of those, what has been hedge accounted. The exposure draft focuses on those items that have been hedge accounted, however the items not hedge accounted or not hedged at all can far outweigh the size and impact of those that have.

The requirements to disclose forward projections of sales of products and services and purchases of commodities and material, together with details of derivatives hedging these (including hedge amounts and hedged rates) has sparked anxiety amongst treasurers. Companies are not happy about „giving the game away“ particularly if competitors don’t have to report under International Financial Reporting Standards (IFRS). Even some users of accounts that we consulted thought that the disclosures had gone too far in potentially disadvantaging companies against their competitors.

Overall though, the ED is one step in the right direction.

Comments on Specific parts of the ED

Objective of hedge accounting (paragraphs 1 and BC11-BC16)

The exposure draft proposed that the objective of hedge accounting is to represent in the financial statements the effect of an entity’s risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. This aims to convey the context of hedging instruments in order to allow insight into their purpose and effect.

Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

Subject to some qualifications we agree with defining an objective, specifically the reference to the entity’s risk management activities. The placing of a hedge is the activity that arises from an entity’s risk management policies. We believe an accounting standard on hedge accounting should require demonstration of the reasonable link between an entity’s risk management activities and its financial reporting on a risk by risk basis, e.g. foreign exchange and interest rates by currency, commodities by type, inflation, etc...

However the statement: “from particular risks that could affect profit or loss” we feel is too narrow as there are times when corporates use financial instruments to hedge balance sheet exposures which may not result in a profit and loss impact. For example, in accordance with IFRS 9 certain changes in fair value of certain strategic equity investments are posted to OCI and are never reclassified into the income statement. Furthermore many companies normally hedge cash flows and not profit and loss

impacts¹. A reference to how particular risks affect the “financial statements” would be more appropriate.

Instruments that qualify for designation as hedging instruments (paragraphs 5-7 and BC28-BC47)

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

Yes, in practice a treasurer looks for natural offset of financial risks and does not immediately go to the external market to hedge with a derivative instrument².

Derivatives that qualify for designation as hedged items (paragraphs 15, B9 and BC48-BC51)

Question 3

Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

We agree with the combination of an exposure and a derivative as a hedged item as this allows the accounting to reflect what is sometimes the most practical way for a treasurer to hedge the different risks that may exist in the underlying item. In the context of raising funding in one currency and swapping it into a second currency a treasurer may subsequently want to convert that second currency from fixed to floating (or vice versa) in which case, the ability to designate a derivative as the hedged item is most welcome.

We would ask that further direction is provided on accounting for these layered structures in the application guidance.

Designation of risk components as hedged items (paragraphs 18, B13-B18 and BC52-BC60)

Question 4

Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (i.e. a risk component), provided that the risk component is separate identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

¹ Some companies have started hedging profit and loss effects, e.g. hedging to invoice date rather than expected cash outflow, wholly in order to comply with IAS 39. This is despite the economic inefficiency of hedging this way. This was one of the perverse effects of IAS 39.

² Some companies started gross hedging, despite its inefficiencies, on the introduction of IAS 39. This was one of the perverse effects of IAS 39.

Under current IAS 39 only foreign exchange (FX) risk can be separated from non-financial items. This excluded some risks, such as commodity risks, from being hedge accounted even though they are often being specifically hedged by the treasurer. Hence, we agree with the proposal that other risk components should be allowed to be designated as a hedged item.

We concur with the approach that risk components do not need to be explicitly specified in a contract in order to qualify as a hedged item but can also be implicit in the fair value or cash flows of the contract.

Designation of a layer component of the nominal amount (paragraphs 18, B19-B23 and BC65-BC69)

Question 5

- a) *Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?*
- a) We agree with layered hedging as this reflects the commercial reality of treasury risk management policies.

We have interpreted that the following examples would be eligible components of a nominal amount under the following two approaches:

- on a percentage basis: 60% of variable rate interest payments of a loan
- on a layered approach: for two bonds totalling £100m each, £60m of the total £200m

Under IAS 39, the treasurer had to designate for hedge accounting purposes which specific debt instrument was being hedged by a derivative, which caused problems if that debt instrument was restructured. The exposure draft addresses this issue.

- b) We understand the Board's decision not to allow layered hedging where a prepayment option has been included for banks hedging a portfolio. We have not provided comment on this.

Hedge effectiveness requirements to qualify for hedge accounting (paragraphs 19, B27-B39 and BC75-BC90)

Question 6

Do you agree with the effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what changes do you recommend and why?

IAS 39 permits hedge accounting only if a hedge is highly effective i.e. if the offset is within the range of 80-125%.

The exposure draft proposes eliminating the 80-125% „bright line“ for testing whether a hedging relationship qualifies for hedge accountings and replaces it with a more objective-based assessment. The proposed hedge effectiveness requirements are that in a hedging relationship:

- a) Hedge designation must be unbiased i.e. no deliberate mismatch in weightings between the hedged item and hedging instrument and reflect the optimal hedge ratio to minimise hedge ineffectiveness; and
- b) It is expected to achieve other than accidental offsetting.

We agree that the removal of the arbitrary 80-125% bright line is a step in the right direction, as this did result in some anomalies where perfectly good hedging relationships did not comply. For example, a small number divided by a small number in an effectiveness test calculation could cause a hedge relationship to be ineffective, even though it was an excellent economic hedge.

The requirement for a hedge designation to be unbiased is likely to lead to extensive analysis and debate with auditors. Any ineffective portion will pass through the profit and loss account and this should be a sufficient deterrent. Hence we do not believe the “unbiased” requirement is necessary.

Rebalancing of a hedging relationship (paragraphs 23, B46-B60 and BC106-BC111)

Question 7

- a) *Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?*

The exposure draft proposes that when a hedging relationship no longer meets the objective of the hedge effectiveness assessment but the risk management objective for that designated hedging relationship remains the same, an entity should rebalance the hedging relationship so that it meets the objective of the hedge effectiveness assessment again. In these circumstances the revised hedging relationship should be accounted for as a continuation of an existing hedge rather than as a discontinuation, as is the case currently under IAS 39.

- a) We agree with the introduction of the concept of rebalancing as it acknowledges that a treasurer can and does make adjustments to a hedge without the need to discontinue and then re-designate a new hedge in order to achieve hedge accounting. However we do not agree with mandatory rebalancing of hedging relationships. We believe it should be at the entity’s discretion i.e. voluntary and not compulsory. We do not believe that mandatory rebalancing is necessary because any ineffectiveness will flow through the profit and loss account. There may be a potential case where underhedging in a cash flow hedge would result in a shift in

basis risk not impacting the profit and loss. This needs to be further investigated. In addition there may be situations where an entity is not able to trade in the financial markets at the time when the mandatory rebalancing may be required. This could for example arise because of lack of available credit lines or due to insufficient cash available to the entity where the instruments that it would need to use for rebalancing are centrally cleared and require initial and variation margin payments.

Whilst the exposure draft purports to align hedge accounting with risk management by removing the bright lines for hedge effectiveness, it has replaced them with mandatory rebalancing. We also note that a shift in basis risk is not usually instantaneous, as the exposure draft assumes, but are changes due to market fluctuations or market trends that only become apparent over time and can only be confirmed after a long period of observations. The exception to this being a change in the ratio of one currency pegged to another. Given the same risk management objective, different treasurers may take different hedging decisions. Therefore, the treasurer's decision about what level of basis shift might require rebalancing is very subjective as is that of whether the movement in the market is only due to short-term volatility and rebalancing isn't required.

We note that rebalancing is unnecessary in situations where the hedge ratio between the underlying hedged item and hedging instrument is 1:1, i.e. where basis risk doesn't exist. Our feedback indicated that there was some confusion as to what rebalancing is. We believe either the accounting standard or the application guidance notes would be more useful if they also provided further details on relevant situations that require rebalancing including worked examples.

- b) We concur that an entity can, if they wish, rebalance the hedging relationship if they expect the hedging relationship to not meet the hedge effectiveness assessment in the future. We agree that it should be at the company's discretion and not be mandatory.

Discontinuing hedge accounting (paragraphs 24, B61-B66 and BC112-BC118)

Question 8

- a) *Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?*

The exposure draft prohibits voluntary de-designation of a hedging relationship when all the qualifying criteria of a hedge are still met. The IASB are effectively stating that if a company's risk management hasn't changed then the accounting shouldn't change either. However we disagree with prohibiting de-designation of a hedge relationship as this is not aligned with typical treasury risk management practices.

For example, although treasurers often economically hedge a forecast foreign exchange cashflow up to the point of expected receipt or payment, they may only hedge account up to the point of recording the sales invoice or receipt of purchased goods on-balance sheet. This is because they get natural offset by the revaluation of both the on-balance sheet receivable/payable and the hedging instrument from that point in time.

Another example is a company that has an „in the money“ derivative and has a cash shortfall. Currently the treasurer has the freedom to either close out the derivative with their financial institution or to enter into an equal and opposite derivative position. Closing out a derivative is the more expensive alternative because banks charge funding and other costs. When choosing the cheaper alternative, entering into an equal and opposite derivative position, the treasurer de-designates the existing swap so that its fair value as well as that of the new swap offset in the income statement. The risk management objective hasn't changed, the company is still following policy and will enter into a new hedge at current market levels. In this situation the proposals in the ED would either result in a real cash cost to the entity on close out of the existing swap or lead to significant profit or loss volatility because the existing hedge would continue and the offsetting swap would be revalued through the income statement.

However if we ignore the costs involved (such as funding, crossing the bid-offer spreads) the prohibition of voluntary de-designation could relatively easily be over-ridden by a treasurer closing out the existing derivative and taking out a new one.

Accounting for fair value hedges (paragraphs 26-28 and BC119-BC129)

Question 9

- a) *Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?*
- c) *Do you agree that linked presentation should not be allowed for fair value hedges? Why or Why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?*

Under IAS 39 there are two distinct hedge accounting models, cash flow and fair value. Basically, cash flow hedges are accounted for through Other Comprehensive Income (OCI) and fair value hedges are accounted for by adjusting the carrying value of the hedged item.

The exposure draft goes some way to proposing a single hedge accounting model for both cash flow and fair value hedges as it proposes that all fair value changes in the hedged item and hedging instrument should be recognised in OCI (with ineffectiveness taken to profit and loss). However this only changes the accounting mechanics for fair value hedges and has no overall impact on the accounting result. To the extent a fair value hedge is effective the change in fair value of the hedged item and hedging instrument will always offset in OCI (under IAS 39 the offset was in the profit and loss account) i.e. there is no net impact on OCI.

- a) We do not agree with accounting for fair value hedges through OCI as we do not see what useful benefit it will provide users of the accounts and adds unnecessary complexity to the OCI account as there are more items “washing through” it.

We acknowledge it would provide overview of hedge ineffectiveness for both cash flow and fair value hedges however this does not represent all economic hedges, only those that have been hedge accounted and hence gives spurious importance to a meaningless number

- b) One of the criticisms of IAS 39 has been the asset or liability subject to fair value has been carried at neither amortised cost or full fair value but somewhere in between. The exposure draft proposed a change to the presentation of fair value hedges by recording the hedge gain or loss, not as an adjustment to the carrying value of hedged item, but as a separate balance sheet line item presented with assets (or liabilities) to which the hedged item belongs.

We agree that this proposal removes the anomaly that IAS 39 presented, however we believe this should be presented in the same line item as the asset/liability on the face of the balance sheet with a separate disclosure in the relevant note to the accounts, and not as a separate line item on the face of the balance sheet. This not only reduces clutter on the face of the balance sheet but also does not represent the item as a separate asset or liability in its own right, which it isn't. Spurious assets or liabilities can have unfortunate public relations effects.

- c) Linked presentation is a way of showing how certain assets and liabilities are related but does not net them on the face of the balance sheet. The IASB considered linked presentation for the financial asset (or liability) and hedging instrument for fair value hedges but concluded that it wasn't appropriate because it did not differentiate between the types of risk covered by that relationship and those that are not.

Accounting for the time value of options for cash flow and fair value hedges (paragraphs 33, B67-69 and BC143-BC155)

Question 10

- a) *Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (e.g. like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?*
- c) *Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (i.e. the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?*

Under IAS 39 the time value of an option is accounted for at fair value through profit and loss. The exposure draft reduces profit and loss volatility by proposing that the time

value should be accounted for in OCI (with any ineffectiveness taken to profit and loss) and transferred to profit and loss over time (the timing based on whether the hedged item is „transaction related“ or „period related“).

- a) For transaction related hedged items the change in fair value of the option’s time value is transferred from OCI to profit and loss on a matching basis e.g. when the hedged sales impacts the profit and loss account.

We agree with the above as the timing of the profit and loss impact for the hedging instrument matches that of the underlying hedged item.

- b) For period related hedged items the change in fair value of the option’s time value is transferred from OCI to profit and loss, on what is effectively an amortised basis.

We agree with the above as it smoothes the profit and loss impact of the option’s time value, however we would ask for clarification of what amortisation methods are deemed acceptable on “a rational basis”.

- c) The „aligned time value“ of an option is the theoretical time value if the critical terms of the option and underlying perfectly match. Hence where the critical terms do not match, the exposure draft requires that the „aligned time value“ is calculated and only this portion is transferred from profit and loss based on the above option time value accounting methodology. We have assumed we do not need to consider aligned time value when the principal terms (i.e. notional, length of time, underlying) of the hedged item and hedging option exactly match. This should be made more explicit.

Whilst we understand what the IASB is trying to achieve in calculating „aligned time value“ we believe that very few treasurers will have the system capability or expertise to calculate this. Option valuation models do not present time value as a separate component and this will need to be calculated or outsourced at additional expense.

We would also point out that the profit and loss impact is unlikely to be material between accounting for aligned time value and actual time value. The time value component of an option’s total value is usually quite small relative to the intrinsic value. The proposal requires a considerable amount of work to calculate and account for the aligned time value and should only be performed for expected material differences if at all.

Hedges of a group of items (paragraphs 34-39, B70-B82 and BC156-BC182)

Eligibility of a group of items as the hedged item (paragraphs 34, B70-B76, BC163, BC164 and BC168-BC173)

Question 11

Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

Paragraph 34 of the exposure draft extends the use of hedge accounting to net positions if:

- The items in the group are managed together on a group basis for risk management purposes; and

- For the purposes of cash flow hedging only, any offsetting cash flows in the group of hedged items, exposed to the hedged risk, affect profit or loss in the same period and only in that reporting period

For forecast transactions (cash flow hedges) practically it would appear that for an average manufacturing company the foreign exchange risk in forecast sales and purchases cannot be hedge accounted on a net basis because they will typically impact the profit and loss in different periods – even when the cash flows are expected to be in the same period. In any case, a forecast sales receivable cash flow impacts profit and loss when the sale is made, but a forecast purchase payable cashflow impacts profit and loss only when the manufactured item(s) is/are sold, which is dependent on the rate of stock turnover and divisibility of the product.

One purchased quantity may go to make many finished product that may be sold over many periods, but which periods may not easily be tracked.

We believe the exposure draft has not gone far enough and should allow hedge accounting for sales and purchases, even if they impact the profit and loss account in different reporting periods. The amount that has been deferred in OCI should be grossed up for the sales and purchases and then accounted for through profit and loss in the relevant accounting periods.

Presentation (paragraphs 37, 38, B79-B82 and BC174-BC177)

Question 12

Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (e.g. in a net position hedge), any hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

For an entity that applies hedge accounting on a net basis, any hedging instrument gains or losses recognised in profit or loss shall be presented in a separate line in the income statement.

For example:

	CU
Sales	X
Cost of sales	(X)
Hedging gain/(loss)	<u>X/(X)</u>
Gross profit	X

We strongly disagree with the proposal to disclose those items with offsetting risks in a separate line on the face of the income statement. This number is meaningless and misleading to users of the accounts as it represents only part of the profit and loss impact of hedges. For those items hedged on a gross basis the profit and loss impact from hedging is recorded as an adjustment to the underlying item in the profit and loss e.g. sales, cost of sales, interest expense etc.

Disclosures (paragraphs 40-52 and BC183-BC208)

Question 13

- a) *Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?*
- b) *What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?*

The exposure draft proposes quite significant changes to current disclosure requirements under IAS 39. Information must now be provided about:

- I. An entity's risk management strategy and how it is applied to manage risk;
- II. How the entity's hedging activities may affect the amount, timing and uncertainty of its future cash flows; and
- III. The effect that hedge accounting has had on the entity's balance sheet, OCI and profit and loss.

We note that the additional disclosure requirements give more prominence to the effects of hedge accounting on the financial statements. However we would point out that:

- They may require commercially sensitive data to be disclosed including forward projections of sales of products and services and purchases of commodities and material, together with details of derivatives (partially) hedging these (including hedge amounts and hedged rates) which could be detrimental to a company. Commercial sensitivity is of particular concern to those corporates whose competitors are not listed companies or who do not report under IFRS.
- They will require significant effort to produce these disclosures. For example Point III above requires three different tables.
- We disagree with including more lines in the primary statements and the confusion this will cause and believe the notes to the accounts are the appropriate place to add further detail.

Accounting alternatives to hedge accounting (paragraphs BC208-BC246)

Accounting for a contract for a non-financial item that can be settled net in cash as a derivative (Appendix C and paragraphs BC209-BC218)

Question 14

Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

The IASB have included the above for companies with commodity contracts where the contract doesn't currently fall under the definition of derivative under IAS 39 (and is

instead being accounted for as a normal sale or purchase contract). Instead of them applying hedge accounting, which the IASB admit would be “administratively burdensome” the above has been included to allow these firms to fair value account for the commodity contract, and hence have offset in the profit and loss for any derivatives hedging these commodity contracts.

Accounting for credit risk using credit derivatives (paragraphs BC219-BC246)

Question 15

- a) *Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?*
- b) *If not, which of the three alternatives considered by the Board in paragraphs BC226-BC246 should the Board develop further and what changes to that alternative would you recommend and why?*

The above has been included for financial institutions in relation to the accounting of credit risk on debt instruments (financial assets).

We have not made any comment on this matter.

Effective date and transition (paragraphs 53-55 and BC247-BC254)

Question 16

Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

Summary of proposal:

- Applies for annual periods beginning on or after 1 January 2013 with earlier application permitted.
- Disclosures need not be applied in comparative information for period before initial application because retrospective application is not applicable.
- Hedge accounting requirements can only be applied if all existing IFRS 9 requirements are adopted at the same time.

We agree that all components of IFRS 9 should be adopted together and believe the timing of adoption should be considered as part of the bigger picture of other new IFRS standards and amendments being issued.

IFRS 9 represents a significant change to IAS 39 in both principal and practical terms. Treasurers will need to assess and modify as required:

- risk management instruments, e.g. options may in the past have been explicitly disallowed because of the accounting treatment;

- the process of hedge accounting e.g. effectiveness testing;
- the mechanics of hedge accounting e.g. changes to fair value hedge accounting;
- valuation methodologies e.g. the ability to calculate aligned time value;
- systems implications for all of the above; and
- whether they regard hedge accounting as worth all the effort and artificiality or they would be better off explaining more clearly to their stakeholders and not hedge accounting at all or in part.

We agree that comparative disclosure information should not be required. Given that hedging relationships can only be designated prospectively, it would not be practical to apply IFRS 9 retrospectively.

Additional comments:

In addition to the specific questions raised by the IASB we provide comment on the following additional items:

Cash flow hedges (paragraph 29)

We do not agree with the mandatory basis adjustment for the recycling of items in OCI. We believe that users should be given a choice, as they currently have under IAS 39, whether to adjust the non-financial asset/liability or keep the amount in the cash flow hedge reserve until the time that the underlying cash flow impacts profit and loss.

A common example of this is that of forecast foreign denominated purchases hedged by a forward foreign exchange contract. Under current cash flow hedging the movement in the hedging instrument remains in OCI until the purchase physically occurs and then there is a choice whether to adjust the stock carrying value or keep the amount in OCI until the item of stock is sold (at which time it is taken to profit and loss). Mandatory basis adjustments can add extreme operational complexity to a company's accounting methodology as inventory systems cannot capture and track these adjustments.

Calculation of ineffectiveness using discounted spot rates (paragraph B43)

The application guidance states that in calculating hedge effectiveness, an entity shall consider the time value of money. Whilst in principal we agree with this we believe it should not be mandatory because in some circumstances it could give rise to unwarranted ineffectiveness. For example, when designating only the undiscounted spot component and not the forward interest points in a foreign exchange exposure.

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<p>Contacts: Michelle Price, Technical Officer (020 7847 2578; mprice@treasurers.org) Martin O'Donovan, Assistant Director, Policy and Technical (020 7847 2577; modonovan@treasurers.org) John Grout, Policy and Technical Director (020 7847 2575; jgrout@treasurers.org)</p>	<p>The Association of Corporate Treasurers 51 Moorgate London EC2R 6BH, UK</p> <p>Telephone: 020 7847 2540 Fax: 020 7374 8744 Website: http://www.treasurers.org</p>
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Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

To the International Accounting Standards Board

Comments on IASB “Hedge Accounting”

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) made in response to the solicitation of comments regarding the International Accounting Standards Board Exposure Draft “Hedge Accounting”. JFTC is a trade-industry association with trading companies and trading organizations as its core members, while the principal function of its Accounting & Tax Committee is to respond to developments in domestic and international accounting standards. (Member companies of the Accounting & Tax Committee of JFTC are listed at the end of this document.)

I. General Comments

The stated objective of the ED is to improve IAS 39 by such means as eliminating the 80–125 percent “bright line” for assessing hedge effectiveness so as to align hedge accounting more closely with an entity’s risk management activities and provide more useful hedge accounting information. As such, we are in favor of the overall thrust of the proposals. However, we find that certain ambiguities remain pertaining to the preparation of financial statements. Hence, we request that additional examples and guidance be offered in order to provide materials for judgment by management and to render the proposed changes more understandable and useful for users of accounting standards.

From the perspective of convergence between IFRS and US GAAP, we request that continued efforts be made to pursue consistency with the FASB exposure draft.

II. Specific Issues (Comments on Questions)

Question 1

We agree with the proposed objective of hedge accounting.

However, for the following reasons, we do not agree with the ED statement that hedge accounting cannot be applied to equity instruments designated as at fair value through other comprehensive income (FVTOCI).

- Equity instruments have an impact on corporate value by acting on other comprehensive income (OCI) to cause changes in statements of financial position and statements of comprehensive income. Therefore, entities may undertake hedge transactions to hedge against fluctuations in the value of equity instruments. In this case, if only the fluctuation in the value of the hedging instrument is recognized in profit or loss, this would generate an asymmetry in accounting and would fail to accurately reflect the economic position of the entity.

In particular, this is an important issue for Japanese trading companies that hold large amounts of strategic foreign-currency denominated investments. For such entities, foreign currency risks arising from equity instruments designated as at FVTOCI cannot be ignored.

The ED proposal argues that the above contradicts the hedge accounting principle that hedge ineffectiveness should be recognized in profit or loss, and that there is considerable resistance to allowing for exceptional treatment on this point. However, IFRS 9 does allow for exceptional treatment of designating equity instruments as at FVTOCI. Taking into consideration that entities actually undertake hedge transactions for such equity instruments, we believe that rules should be established to allow for the application of hedge accounting to equity instruments designated as at FVTOCI.

In describing the objectives of this ED, paragraph IN3 mentions the following points: (a) to align hedge accounting more closely with risk management and hence result in more useful information; and (b) to establish a more objective-based approach to hedge accounting. In light of these points, allowance for exceptional treatment should be acceptable if the end result is compatible with the aim of the ED, which is to more closely align hedge accounting with the economic reality of the entity. From the perspective of properly reflecting the economic reality of risk management related to hedging the fluctuation risks in OCI, we believe the following treatment should be allowed: the application of hedge accounting to equity instruments designated as at FVTOCI should be allowed; the ineffective portion related to the hedged item should remain under OCI; and the effective portion related to the hedging instrument should be recognized in OCI.

Question 4

We support the proposal. However, we request that the following points be given due consideration.

- The expressions “separately identifiable” and “reliably measureable” are too abstract and do not provide enough information for practical application. Therefore, we request additional guidance.
- In commodity spot contracts, prices are set separately for each risk component (forward, premium, etc.), and entities frequently undertake hedge operations for each risk component. Although such components are not necessarily specified in the contract, in almost all instances it is possible to determine them by risk component. On the other hand, for nonfinancial instruments that are not forward market traded—commodities, we believe that it is necessary to provide more detailed explanations of what constitutes a “separately identifiable” and “reliably measureable” risk component. For instance, the price of copper affects prices for copper wires, electric cables, automobile parts, automobiles, and so on. For such a chain of products, we request clarification on how far along the chain the risk component related to the price of copper can be considered identifiable.
- In certain cases, an entity will undertake hedge operations to cover the anticipated cash flow from the forecast transactions of an affiliated company engaged in selling minerals. As the investing company, suppose this entity enters into forward selling contracts to protect itself from future fluctuations in the price of minerals by hedging its share of revenue from future sales of minerals by an equity-method affiliate engaged in mineral extractive activities. From an economic perspective, the investing company has hedged its cash flow from the affiliate’s scheduled sales of minerals and has thereby acted to control the fluctuations in its equity-method profit or loss that would be recognized at some point in the future.

However, under both the current and proposed accounting treatments, hedge accounting cannot be applied to such transactions for the following reasons, and it is normally interpreted that market-price fluctuations pertaining to the forward contract must be recognized in profit or loss.

- Because the cash flow from forecast transactions pertains to the affiliate and does not accrue to the consolidated financial statements of the investing company (other than in exceptional cases where, for example, the affiliate’s cash flow is fully and immediately distributed as dividend), cash flow hedge cannot be applied.

- Because equity-method profit or loss is recognized in profit or loss, fair value hedge also cannot be applied (ED paragraph B8).

Basically, hedging is an action undertaken by management to intentionally control the impact of market fluctuations on the entity's financial statements. In this context, we believe that hedge accounting is aimed at reflecting such actions in accounting. Paragraph 18 of the ED states that a risk component may be designated as a hedged item when it is separately identifiable and reliably measureable. In the example presented above, the hedging instrument (forward contract) is clearly tied to the affiliate's hedged item (forecast transactions), and if we adopt the assumption that the hedged item is a transaction undertaken by the investing company, this becomes a transaction to which hedge accounting can be applied. Therefore, hedge accounting should be applicable to an equivalent transaction by the affiliate.

Question 5

We agree with the proposal.

For instance, take a power generation business that is subject to uncertainties related to amounts of power generated and sold. A high level of effectiveness can be ensured if only the quantity that is certain to be sold, can be designated as a hedged item.

Question 6

We agree with the proposal.

However, the hedge effectiveness requirements of "expected to achieve other than accidental offsetting" and "minimise expected hedge ineffectiveness" may be difficult to judge. Therefore, we request the inclusion of additional examples and guidance on these requirements.

Question 7

We agree with the proposal.

However, we request the inclusion of detailed guidance on rebalancing of hedging relationships.

Question 9

We do not agree with the proposal.

- The ED proposal produces the same outcome in profit or loss as the current IAS 39, which stipulates that gains or losses related to both hedged items and hedging instruments must be

recognized in profit or loss. As such, the ED proposal does not represent a substantive change. The ED proposal is expected to have the following effects: [1] presents in one place the effects of risk management activities (for cash flow and fair value hedges) (paragraph BC123(c)); and [2] provides information in OCI about the extent of the offsetting achieved for fair value hedges (paragraph BC123(d)). With regard to [1], we believe there is no compelling reason why cash flow and fair value hedges have to be presented in the same place because fair value hedges are not to be replaced by a cash flow hedge mechanism but are to be subject to a different approach. With regard to [2], the same effect can be obtained by disclosure requirements as specified under paragraph 51.

Preparers of financial statements are in compliance with IAS 39, and it can be assumed that various systems have been developed for this purpose. It is likely that the changes proposed in this ED will require changes to be made in these systems. As mentioned above, the ED proposal does not contain substantive changes. Therefore, we cannot support the proposal from a cost-benefit perspective.

- In the event that the ED proposal is adopted in its present form, we would request that consideration be given to the following points.

Under the ED proposal, changes in fair value of hedged item and hedging instrument in a fair value hedge are to be first recognized in OCI, and thereafter the ineffective portion is to be transferred to profit or loss. We understand that the intent of this procedure is to convey a more accurate picture of an entity's hedging activities to users of financial statements by separately presenting the following three components in a fair value hedge: [1] changes in the fair value of the hedged item; [2] changes in the fair value of the hedging instrument; and [3] ineffective portions transferred to profit or loss. The ED does not contain concrete explanations and examples of presentation methods. However, taking into account the intent of the proposal, we believe that [1] to [3] should be presented in gross terms. This instruction should be explicitly included in the standard. Alternatively, we believe it would be necessary to provide presentation examples in application guidance of the standard.

Question 10

We agree with the proposal. However, we request that the following points be given due consideration.

- Consideration should be given to the time value of hedging instruments in hedging net investments in foreign operations

(paragraph BC141). For instance, paragraph F.6.4 of IAS 39 stipulates the treatment of the difference between spot and forward rates when forward exchange contracts are used as a hedging instrument. On the other hand, the ED proposes that in the treatment of the time value of options, entities should distinguish between transaction related hedged items and time period related hedged items. However, we request that other treatment methods be considered for the time value of hedging instruments in hedging of net investments in foreign operations, including recognition in other comprehensive income.

- In light of the administrative burdens involved, entities should be allowed to directly recognize in profit or loss changes in the fair value of time value not designated as hedging instruments.

Question 13

We agree with the proposal.

- It is necessary for entities to provide information that is useful to the users of financial statements. As such, we believe entities should be required to disclose qualitative information regarding their thinking and policies on the application of hedge accounting to risk management.
- For derivatives valuation gains and losses (and end-term balances), amounts to which hedge accounting is applied should be disclosed separately from the rest because these provide financial statement users with useful information on the relation between the entity's derivatives transactions and its hedge accounting (amendment of IFRS 7). Regarding requirements for quantitative information, we request that due consideration be given to practical issues so as to avoid excessively detailed disclosure requirements.

Question 14

We do not agree with the proposal on the following points.

- In the proposal, the scope of the application of derivative accounting to contracts for the sale or purchase of nonfinancial items is limited to "contracts that can be settled net in cash." However, for purposes of risk management, entities may in certain cases use commodities futures, etc., as hedging instruments to hedge commodities contracts and inventory items that cannot be settled net in cash. Paragraph BC 217 states the following. "Consequently, the actual type of settlement (ie whether settled net in cash) would not be conclusive for the evaluation of the appropriate accounting treatment. Instead, an entity would not consider only the purpose (based solely on the actual type of settlement) but also how the contracts are

managed.” In consideration of this statement, we request that the scope of application of derivative accounting be broadened to include contracts that cannot be settled net in cash as well as those that can be settled net in cash. (In this case, it should be noted that although in some instances cash flow hedge accounting could be applied to a hedging instrument, an entity’s risk management activity may in itself be intended for the purpose of fair value hedging. Therefore, in this regard, we request that hedge accounting treatment be made to correspond to the economic reality of the transaction.)

- One of the conditions requires that net exposure be maintained at near zero. However, what is really important is for operations that are managed using mark-to-market accounting for a portfolio containing the entity’s outstanding commodity contracts and inventory to be appropriately reflected in the financial statements. Therefore, we believe that keeping the net exposure near zero is unnecessary (it does not have to be an alternative to hedge accounting). Furthermore, in order to achieve the above objective, it is important to allow fair value assessment of inventory contained in the portfolio. We believe that the original intent of the revision proposed in the ED cannot be achieved unless fair value measurement of inventory as stipulated under IAS 2 paragraph 3(b) is made to correspond to the scope of outstanding contracts treated as derivatives under IAS 32.

III. Others

<Forecast Transactions>

“Highly probable forecast transactions” are eligible for designation as a hedged item under cash flow hedges. In this regard, we believe that guidance is necessary on the period of forecast transactions. While some guidance on this matter can be found in paragraph F.3.11 of IAS 39, this guidance is insufficient.

<Open Portfolios>

The ED proposals effectively broaden the scope of the application of hedge accounting by eliminating the 80–125 percent quantitative criteria for assessing hedge effectiveness and by including net positions as eligible hedged items. However, the ED proposals go no further than closed portfolios that remain unchanged during the period of the hedge, and it is stated that the Board is continuing to discuss proposals for hedge accounting for open portfolios in which hedged items are subject to constant change. It should be noted that financial institutions are not the only entities with hedged items that are subject to constant change, and the same can be seen among

nonfinancial companies as well. Unless greater flexibility is permitted in this area, the aim of the ED to expand the scope of hedge accounting will meet with only limited success.

Therefore, we request that due flexibility be included in the proposals on open portfolios scheduled for release this year so that the effects of an entity's risk management activities can be properly expressed in financial statements.

Japan Foreign Trade Council, Inc

World Trade Center Bldg. 6th Floor,
4-1, Hamamatsu-cho 2-chome,
Minato-ku, Tokyo 105-6106, Japan
URL. <http://www.jftc.or.jp/>

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