The Association of Corporate Treasurers

Request for feedback:
Hedge Accounting Exposure Draft ED/2010/13

Specific questions where feedback is requested marked in red.

1. Disclosure of commercially sensitive information

The exposure draft proposes quite significant changes to current disclosure requirements under IAS 39.

Information must now be provided about:

For each category of risk, an entity shall disclose quantitative information for the future periods that the hedging relationship is expected to affect profit and loss:

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. (this requires three separate tables to be presented)

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 e.g. total exposures, what average hedged rate was achieved etc. which we believe could be detrimental to a company [We are seeking specific examples here of situations where these disclosures would cause commercial sensitivity issues.]

Example numerical disclosure presented by the IASB in their illustrative examples:

Commodity price risk

The company's hedge position can be summarised as follows:	**20X0**	**20X1**	**20X2**
Basis of total price risk exposure (barrels of oil per day)	55,000.00	60,000.00	65,000.00
Exposure hedged			
Forward sales contract			
Basis of hedged exposure (barrels of oil per day)	14,500.00	6,000.00	6,000.00
Average hedged rate USD/per barrel	81.75	85.50	88.00
Put options			
Basis of hedged exposure (barrels of oil per day)	14,500.00	6,000.00	nil
Average hedged rate USD/per barrel	≥75.00	≥70.60	nil

Interest rate risk

The company's interest rate risk exposure can be summarised as follows: **Fixed interest—loans payable**				
	20X0	**20X1**	**20X2**	**20X3**
Basis for total interest rate risk exposure (CU million)	40.00	30.00	20.00	10.00
Average fixed interest rate	6%	6%	6%	6%
Exposure hedged				
Basis for the exposure hedged	40.00	30.00	20.00	10.00
Receive fixed interest payments	5.90%	5.90%	5.90%	5.90%
Pay floating interest rate	LIBOR+2%	LIBOR+2%	LIBOR+2%	LIBOR+2%

Please note:
This example illustrates a simplified scenario. In situations where an entity hedges the interest rate risk of many loans (or other items), it might be more appropriate to present the disclosure using a maturity analysis format for each type of hedge.
For example:
1 year 2-5 years >5 years
Fixed interest loans payable
Etc…

Foreign exchange risk

The company has limited exposure to foreign exchange risks. Its purchases and sales are mostly denominated in its functional currency.

The company's hedge position can be summarised as follows: **USD/EUR exposure—Assets**	**20X0USD million**
Basis for total foreign exchange risk exposure managed (firm commitment)	6.00
Exposure hedged	
Basis for the foreign exchange risk hedged Average hedged rate	6.00 n/a

Question 1

We believe the above may require commercially sensitive information to be disclosed, however it is not enough to go back to the IASB and state that. We need specific examples of how these disclosures would be commercially sensitive, and hence detrimental to a company.

Would the above level of disclosure be commercially sensitive to your company?

If yes, how and please provide examples.

2. Mandatory rebalancing

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 <u>should</u> 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.

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. [Potential case where underhedging in cash flow hedge would result in shift in basis risk not impacting p&l: to be investigated].

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. 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 and hence the decision at what level of basis shift does a treasurer rebalance is very subjective, or indeed 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. We believe either the accounting standard or the guidance notes would be more useful if they provided further details on relevant situations that require rebalancing including worked examples.

Question 2

We need some good examples of companies (probably with basis risk in their hedges) where they would be required to rebalance under IFRS 9 and to understand the negative implications.

Do you have hedges with basis risk and currently hedge account or would under IFRS 9?

If yes, we need practical examples why mandatory rebalancing isn't necessary for your situation.

3. De-designation prohibited

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 would 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 addition this rule is easily over-ridden by a treasurer buying an offsetting derivative position and then applying hedge accounting to the combined positions.

Question 3:

Is there a good/valid reason in your company why you would want the ability to de-designate a hedge going forward (given that you are able to rebalance the hedge)?

4. Other issues

I would also be interested in talking to you if you have any thoughts/comments on the following:

- Calculation of ineffectiveness using discounted spot. This would require (as it not always current practice) for treasurers to use cashflows when using short term rolling forward contracts when the designation is only to hedge the undiscounted spot component, but not the interest component.
- Accounting for a fair value hedges through OCI. (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.)
- Cashflow hedge accounting and mandatory basis adjustment: e.g. if hedging forecast purchases the requirement is that you must now adjust stock for the value of the hedging instrument sitting within OCI. Previously you could leave it in OCI and 'recycle' it directly to profit and loss when the stock was sold.
  Does this a significant operational impact on your company?
  Question 5: Can inventory systems cope with this and if not do you have a practical work-around to implement this?
- 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)	X/(X)
Gross profit	X

  We 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.

  Question 6: As a recommendation how practical is it to apportion the net hedge profit and loss to its individual components? E.g. split FX gain between sales and advertising expense

- We would welcome any other comments/thoughts on the exposure draft.

Please email *technical@treasurers.org*