ACT

The Association of Corporate Treasurers Ocean House 10-12 Little Trinity Lane London EC4V 2DJ
Tel 020 7213 9728 Fax 020 7248 2591

Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

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Direct Line: 020 7213 0715
Email: modonovan@treasurers.co.uk

Dear Madam,

July 2004 Exposure draft re amendments to IAS 39: Cash Flow hedging of Forecast Intragroup Transactions

General

The Association of Corporate Treasurers (ACT) welcomes the fact that the IASB has reviewed and reconsidered this particular topic. The subject of hedging of forecast intragroup transactions is one that we specifically raised with the IASB in February 2004 and therefore your exposure draft designed to address our concerns is much appreciated.

Please note, the ACT usually comments from the corporate and not the financial services sector standpoint.

In the previous version of IAS 39 the interpretation IGC 137-14 allowed a forecast intragroup transaction to be designated as a hedged item in a foreign currency cash flow hedge in consolidated accounts, but we understand that this was deliberately removed. In your Basis for Conclusions, BC 6, you note that one option was to reinstate the specific IGC 137-14 exception, but in BC7 you reject this since it does not fit in with the normal rationale that entities can only obtain hedge accounting for a transaction that will eventually result in an exposure that is not fully eliminated on consolidation.

As an alternative you have looked beyond the forecast intragroup transaction to an eventual external transaction that may be generated from that internal transaction and in BC 13 you note that in group terms this can give rise to a true economic exposure since the external sale (in your example) will have had costs incurred in a different currency. The amendment paragraph AG99A is drafted on this basis.

Response to specific questions

Q1 *Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?*

A1 The ACT agrees that the proposals put forward do provide a mechanism whereby a group may obtain hedge accounting for what we believe to be a valid economic exposure arising from a forecast intragroup transaction.

Q2 *Do the proposals contained in the Exposure Draft appropriately address the concerns set out in paragraph 3 of the Background on this Exposure Draft? If not, why not, and how would you address these concerns?*

A2 We are content that the Exposure Draft does address the concerns set out in paras 3 (a) and (b). As regards the point in 3 (c) that IAS39 differed from SFAS 133, in that under US GAAP hedge accounting is possible for forecast intragroup transactions, this is only partly addressed by the Exposure Draft. The Exposure Draft allows hedge accounting for intragroup transactions through a proxy method of designating a consequent external exposure, whereas under US GAAP it is the actual intragroup item itself that is specifically designated as the hedged item. Although designed to achieve similar results the methodologies will differ, which is to be regretted. This said we do not consider this difference to create any fundamental problems.

Q3 *Do you have any other comments on the proposals?*

A3 The ACT appreciates the move to create an indirect method of hedging intragroup transactions, but we remain puzzled that the method proposed to achieve this is rather in the nature of a work around solution. The proposed treatment effectively takes an external transaction denominated in the functional currency of the entity entering into the transaction and regards this as the hedged item when of itself there is no exposure generated in that entity. The exposure occurs at the consolidated level only. A fundamental feature of IAS 21 is that measurements are done against functional currency and this Exposure Draft appears to depart from this principle.

This seems to be a radical new basis for looking at currency exposures which surprises us. We would have thought that it would be a less radical route to allow the intragroup item itself to be the hedged item.

By going this route the Exposure Draft opens up an entirely new allowable hedging concept, namely that of hedging the consolidated exposure of having subsidiaries which have functional currencies different from the Group presentation currency, even though the subsidiaries may have no FX exposures in terms of their own functional currency. It will now be possible for a GBP based Group to hedge the consolidated earnings of its USD based subsidiaries, for example. The Parent will be able to designate as a consolidated hedged item a proportion of its subsidiaries' USD sales sufficient to equal its USD earnings on consolidation. This is a helpful concept and one which will allow Treasurers the flexibility to decide on Group hedging of earnings without needing to worry about distortions from not being able to get a matched accounting treatment. We welcome this new flexibility, but do wonder if this was really the intent of the proposals?

These comments are on the record and may be freely quoted and made available for public inspection.

We hope these responses are helpful for your deliberations and if you need any further information or clarifications please contact any of the people listed below.

Yours faithfully,

Martin O'Donovan
Technical Officer

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The Association

The Association of Corporate Treasurers was formed in 1979 to encourage and promote the study and practice of corporate finance and treasury management and to educate those involved in the field. Today, it is an organisation of professionals in corporate finance, risk and cash management operating internationally. A professional body and not a trade association, it has over 3,000 Fellows, Members and Associate Members. With more than 1,200 students in more than 40 countries, its education and examination syllabuses are recognised as the global standard setters for treasury education. Members of the Association work in many fields. The majority of Fellows work in large UK public companies, responsible for the treasury and corporate finance functions.

Contacts: Richard Raeburn, Chief Executive (020 7213 0734; rraeburn@treasurers.co.uk) John Grout, Technical Director (020 7213 0712; jgrout@treasurers.co.uk) Martin O'Donovan, Technical Officer (020 7213 0715; modonovan@treasurers.co.uk)	The Association of Corporate Treasurers Ocean House 10/12 Little Trinity Lane London EC4V 2DJ Telephone: 020 7213 0728 Fax: 020 7248 2591 Website: http://www.treasurers.org