CIMA

CL 33

Sandra Thompson,
Senior Project Manager,
IASB,
30 Cannon Street,
LONDON
EC4M 6XH
14 November 2003

Dear Ms Thompson,

Amendments to IAS39 Financial Instruments: ***Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk***

Thank you for giving the Chartered Institute of Management Accountants the opportunity to comment on this Exposure Draft. The Chartered Institute of Management Accountants (CIMA) is a global professional body specialising in management accounting. CIMA represents over 77,000 students and 60,000 members in 155 countries.

The responses to your specific questions are attached below. There are also general points that we think it important to make.

We believe that the only logical basis for a standard on financial instruments, which deals satisfactorily with hedging, is a mark-to-market standard. We understand that there are practical considerations which would make it difficult to proceed with a major and contentious project at the same time as pursuing convergence in Europe and worldwide, and also tackling other difficult issues. However, the approach taken means that IAS 32 and 39 are inherently flawed standards, with anomalies arising at the borders between areas which are marked to market, and those which are not. Problems arise for example in internal hedges, and in complex instruments involving own shares. Organisations with influential and effective treasury departments will be able to control to a degree the profits they report. Organisations without such expertise may in some circumstances find that following a rational, simple hedging policy leads to arbitrary and counter-intuitive financial results, and a lot of paperwork.

We believe that a full mark-to-market solution will eventually fix any problems, and that it is very important to preparers to establish a stable framework quickly. We do not think the finely balanced arguments involved in the contentious parts of this proposal would really justify holding up the transition to IFRS and fully expect the IASB to take a future opportunity to review this area of accounting after 2005. We therefore urge IASB to be flexible and to reach decisions quickly, in the interests of achieving a smooth and orderly transition.

Nevertheless CIMA does regard the amendment proposed by the IASB as an improvement to the standard and does support it.

Yours sincerely

Nick Topazio

Jim Metcalf

Nick Topazio
Business & Financial Reporting Specialist,
Financial Reporting Development Group
Direct Tel: 07855 198893
Direct Fax:
E-mail:
Nick.Topazio@cimaglobal.com

Jim Metcalf
Chairman of Financial Reporting Development Group
01732 740554
0845 280 2323
jim@jimmetcalf.co.uk

Q1. Draft paragraph 128A proposes that in a fair value hedge of the interest rate risk associated with a portion of a portfolio of financial assets (or financial liabilities), the hedged item may be designated in terms of an amount of assets (or liabilities) in a maturity time period, rather than as individual assets or liabilities or the overall net position. It also proposes that the entity may hedge a portion of the interest rate risk associated with this designated amount. For example, it may hedge the change in the fair value of the designated amount attributable to changes in interest rates on the basis of expected, rather than contractual, repricing dates (the repricing date is the date on which the item will be repaid or repriced to market rates). However, the Board concluded that ineffectiveness arises if these expected repricing dates are revised (e.g. in the light of recent prepayment experience), or actual repricing dates differ from those expected. Draft paragraph A36 describes how the amount of such ineffectiveness is calculated. Paragraphs BC16-BC27 of the Basis for Conclusions set out alternative methods of designation that the Board considered, their effect on measuring ineffectiveness and the basis for the Board's decisions including why it rejected these alternative methods.

Do you agree with the proposed designation and the resulting effect on measuring ineffectiveness? If not,

(a) **in your view how should the hedged item be designated and why?**

(b) **would your approach meet the principle underlying IAS 39 that all material ineffectiveness (arising from both over- and under-hedging) should be identified and recognised in profit or loss?**

(c) **under your approach, how and when would amounts that are presented in the balance sheet line items referred to in paragraph 154 be removed from the balance sheet?**

Subject to our overall concern with the fundamental principle expressed in our covering letter, we agree with the proposed designation and the resulting effect on measuring ineffectiveness.

Q2. Draft paragraph A30 (b) proposes that all of the assets (or liabilities) from which the hedged amount is drawn must be items that could have qualified for fair value hedge accounting if they had been designated individually. It follows that a financial liability that the counterparty can redeem on demand (i.e. demand deposits and some time deposits) cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the counterparty can demand payment. Paragraphs BC13-BC15 of the Basis for Conclusions set out the reasons for this proposal.

Do you agree that a financial liability that the counterparty can redeem on demand cannot qualify for fair value hedge accounting for any time period

beyond the shortest period in which the counterparty can demand payment?

If not,

(a) do you agree with the Board's decision (which confirms an existing requirement in IAS 32) that the fair value of such a financial liability is not less than the amount payable on demand? If not, why not?

(b) would your view result in such a liability being recognised initially at less than the amount received from the depositor, thus potentially giving rise to a gain on initial recognition? If not, why not?

If you do not agree that the situation outlined in (b) is the result, how would you characterise the change in value of the hedged item?

CIMA agrees with the IASB approach.