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31 October 2003

Ms Sandra Thompson
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM
By email: CommentLetters@iasb.org.uk

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Dear Ms Thompson

IASB ED "Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurements re Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk"

General

CPA Australia is concerned that the proposed amendments to IAS 39 'Financial Instruments: Recognition and Measurements' regarding fair value hedge accounting for a portfolio hedge of interest rate risk may be perceived to further entrench the acceptability of certain unacceptable hedge accounting practices.

CPA Australia notes the catalyst for the proposed amendments to IAS 39 was from submissions primarily from the banking industry, who are concerned that under IAS 39 their existing portfolio hedging strategies regarding interest rate risk would either not qualify for hedge accounting, or would only qualify for cash flow hedge accounting. The former is alleged to result in increased volatility in the reported result, and the latter reported volatility in equity. As a result, the IASB has proposed an approach to portfolio hedging that it believes is consistent with the principles that underlie IAS 39 for fair value hedge accounting, while also being workable in practice.

It is also noted that the European Union has published the Commission Regulation No. 1725/2003 of 29 September 2003 adopting certain international accounting standards in accordance with Regulation No. 1606/2002 of the European Parliament. With the Regulation, all international accounting standards *in existence* on 14 September 2003 are adopted, *except* for IAS 32 'Financial Instruments: Disclosure and Presentation', IAS 39 'Financial Instruments: Recognition and Measurement' and the related interpretations.

CPA Australia has some qualified sympathy for proposals of the Financial Instruments Joint Working Group (JWG) of Standard-setters 'Accounting for Financial Instruments and Similar Items' (December 2000) in respect of hedge accounting generally. JWG comprised representatives or members of accounting standard-setters or professional organisations in Australia, Canada, France, Germany, Japan, New Zealand, five Nordic countries, the United Kingdom, United States of America and of the International Accounting Standards Committee.

The draft standard of the JWG proposed not to permit special accounting for financial instruments that are entered into as part of risk management activities. The JWG proposed that financial instruments that are used for hedging purposes be recognised and measured at fair value, with gains or losses recognised immediately in the income statement just as for all other financial instruments.

CPA Australia believes that such an approach, coupled with a concomitant change to accounting for the underlying items hedged by entities, is more likely to produce information which is useful to users of financial reports for making decisions. In this respect, the proposals in ED 123 run the risk of retaining the status quo regarding hedge accounting, making any future proposals to move away from hedge accounting more difficult.

We find the arguments for change proposed by the industry, and apparently accepted by the IASB, lacking conceptual rigour. We can accept a compromise, that is hedge accounting should be supported until a method for a more balance approach to recognising movements in fair value, for hedging instruments and underlying hedged items, is developed. Further more, it may be wise to proceed with the ED 123 proposals to gain the acceptability of IAS 32 and IAS 39 by the European Union. The proposals are true to principles that underlie IAS 39 on derivatives and hedging accounting, even though, in our view, the hedge accounting principles are themselves flawed. We would be comforted if the IASB in issuing a standard based on this ED would also confirm that they intend to continue to explore and strengthen financial reporting for financial instruments, including further consideration of the appropriateness of a total review of hedge accounting.

Given that the IASB is pursuing a short-term convergence with the FASB, we had expected the exposure draft to raise the issue of compatibility with US GAAP on this issue.

The introduction of proposed amendments to fair value hedge accounting for a portfolio hedge of interest rate risk leads to further prescriptive rule making in relation to an increasing complex area of hedge accounting, at the expense of more principle-orientated accounting standards.

Conclusion

As noted above, CPA Australia has a number of concerns with hedge accounting and its proposed extension as outlined in ED123. However, for pragmatic reasons, it may be preferable to proceed with the proposals.

The External Reporting Centre of Excellence, on behalf of CPA Australia, has prepared this submission. Please contact Naomi Carroll, Policy Adviser, Accounting and Audit on Tel: (61-3) 9606 9872 or by email naomi.carroll@cpaaustralia.com.au should you have any queries concerning our submission.

Yours sincerely

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