



March 2<sup>th</sup>, 2011

**International Accounting Standards Board**  
**30 Cannon Street, London EC4M 6XH**  
**United Kingdom**

Dear Madam/Sir,

**Exposure Draft ED/2010/13 - Hedge Accounting**

The Israel Accounting Standards Board is pleased to have this opportunity to comment on the IASB's Exposure Draft ED/2010/13 *Hedge Accounting* published in December 2010.

In this comment letter we refer only to the questions regarding requirements that we believe should be clarified or amended. Please find below our detailed comments for these questions. We are in agreement with the Board's proposals regarding questions we did not refer to in our letter.

The Board's objective in the last decade has been to publish principle-based IFRSs. We believe that in most cases this objective was appropriate. However, in an IFRS on Hedge Accounting, significant expansion of the guidance accompanying the ED is required. Our suggestions are listed below according to the questions raised.

**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 generally agree. However, we believe that allowing an aggregate exposure to be designated as a hedged item raises issues that require further guidance. Here are some examples of the issues raised from this proposal:

The measurement of the hedged item, which is a combination of an exposure and a derivative, is unclear. Should it be measured at amortised cost, because hedged items are excluded from the

general measurement requirements in IAS 39 (paragraph 46 of IAS 39) or should it be measured at fair value because it includes a derivative that usually must be measured at fair value? What is the accounting treatment for a derivative that is no longer a hedged item - should it be re-measured to fair value and the gain or loss from the re-measurement be recognised in profit or loss?

#### **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 (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?**

1. In our opinion, there should be no distinction between inflation risk implied in a contract and inflation risk explicitly identified in the contract, and there should be no specific reference to credit risk. The general principle should be applied in both cases, ie if the risk component is separately identifiable and reliably measurable, it qualifies as a hedged item.
2. More principle-based guidance is required as to which risks that are implied in a contract are separately identifiable and reliably measurable.

#### **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?**

We agree. However, we believe that further examples are required to understand the "layer" concept.

#### **Question 6**

**Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?**

We agree. As we understand the proposals, the Board wishes to emphasize the economic relationship between the hedged item and the hedging instrument rather than the statistical correlation between these variables. We also understand that the Board's intention is that statistical correlation would no more validate the economic relationship. Therefore, more guidance is required on the criteria for economic relationship and the ways to validate the economic relationship.

Furthermore, the determination of the method for assessing whether the hedge effectiveness requirements are met is dependent on the alignment of the critical terms of the hedging instrument and the hedged item. The ED states "For example, when the critical terms (such as the nominal amount, maturity and underlying) of the hedging instrument and the hedged item match or are closely aligned, it might be possible for an entity to conclude on the basis of a qualitative assessment of those critical terms that the hedging relationship will probably achieve systematic offset...". We believe that the objective of alignment of the critical terms criterion was a significant facilitation of the hedge effectiveness assessment. Yet, in the absence of more guidelines to the term "closely aligned", the objective is not achieved.

#### **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?**

We agree. We believe that a clarification is required regarding rebalancing in the ED. According to agenda paper 17C regarding interaction between rebalancing and discontinuation, an entity is allowed to set a band in which the volatility is frequent and of a moderate magnitude so that adjusting the hedge position in response to changes within that band would not be economical. The ED does not include any reference to such a band and such a policy option. In our opinion, if the Board supports this example, it should be part of the final Standard.

#### **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?**

We disagree to the proposed presentation. In our opinion, the proposed gross presentation does not benefit the users of financial statements and creates confusion.

**(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?**

We disagree. In our opinion, the disaggregation of the information on the face of the statement of financial position does not add information or better understanding to the financial statements' users.

#### **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?**

We agree. However, the ED does not include guidance for the accounting treatment in case an entity hedged two forecasted transactions that were expected to affect profit or loss in their entirety in the same reporting period, but unfortunately one occurred during the reporting period and the other was postponed and occurred during the next reporting period. Should hedge accounting be discontinued? What is the treatment for amounts previously recognised in other comprehensive income?

#### **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 (eg 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?**

We disagree. The on-going additions of separate line items to the income statement obscure the overall performance of the entity. We suggest that this gain or loss would be classified according

to its nature within an existing line item and disclosure would be provided in the notes to the financial statements. For example, if the entity hedges forecasted sales and purchases, the gain or loss on the hedging instrument would be classified within gross profit.

#### **Question 16**

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

The transition requirements state that this IFRS should be applied prospectively, but includes no further guidance in this matter. Should an entity review all of its existing hedging relationship at the beginning of the implementation period and check their eligibility for hedge accounting according to the new IFRS? If an existing hedge relationship is eligible for hedge accounting, should the entity make a formal designation and documentation of the hedging relationship? Can the entity change the way in which it will assess whether the hedging relationship meets the hedge effectiveness requirements?

**We appreciate the opportunity to provide our comments.**

**Sincerely,**

**Dov Sapir, CPA, Chairman**

**Israel Accounting Standards Board**