

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

Stockholm 9th March 2011

Exposure Draft ED/2010/13: Hedge Accounting

Far, the Institute for the Accountancy Profession in Sweden is responding to your invitation to comment on the exposure draft *ED/2010/13 – Hedge Accounting*.

In general Far believes that the proposals in the ED are major improvements to hedge accounting according to IFRS since it will reduce some of the complexity in the current rules and make it possible to achieve hedge accounting for good reasons in many situations in which this has not been possible under IAS 39. The aligning of accounting with risk management is important to enable users to better understand the effects of risk management. Far believes that removing the 80–125 % effectiveness qualification requirements is fundamental to make hedge accounting more useful to the users. There are however some areas where the ability to achieve the goal of being able to represent the effects of risk management activities could be enhanced even further.

Far agrees with the proposed objective of making the hedge accounting reflect the actual management activities taking place in practice, as explained above. Limiting the objective of hedge accounting, however, to items that affect profit or loss will not make it possible to reflect some valid risk management activities. Strategies that may not be eligible for hedge accounting include, for example, strategic investments with foreign currency risk. Far proposes that the objective of hedge accounting is extended to also include items affecting other comprehensive income or equity.

One of the most important and appreciated improvements in the ED is the ability to hedge risk components also for non-financial hedged items. Hedging risk components is especially important for companies with significant commodity risks. Far supports a principles based approach and agrees that “separately identifiable and measurable” is an adequate principle. In the case of non-contractually specified risk components Far believes that hedge accounting should in many cases be allowed. The requirements however, are not clear and clarification could for example focus on components a market participant would typically consider an essential factor to arrive at the price/fair value of the entire item. Unless the component is thus relevant for market participants in pricing the entire item, it should not be eligible for hedge accounting on a component basis.

Another major improvement in the ED is the removal of the existing qualification criteria that a hedging relationship has to have an effectiveness of 80–125 %. The proposed effectiveness criteria reduces the complexity for many entities with plain vanilla strategies especially for

foreign currency and interest rate hedging since qualitative assessments would be sufficient in many cases.

Some complexity is however introduced with the qualification criteria “the objective of the hedge effectiveness assessment”, which requires that the results of the hedge should be unbiased. This requirement, however, is not further defined and therefore the meaning of it is unclear.

The second aspect of the criteria, minimising hedge ineffectiveness, may cause designations for hedge accounting purposes to be different than the designation for risk management purposes. Far agrees that from a strictly economical perspective an entity would normally pursue the hedge ratio that is economically the most rational hedging ratio but Far does not believe this should be mandated in an accounting standard. An entity may choose a non-optimal hedging ratio because it may be operationally simpler to monitor and more intuitive to explain hedging relationships using a hedging ratio of 1 to 1 even though a different hedge ratio would result in less ineffectiveness.

The complexity of determining the optimal hedging ratio at inception and then continuously monitor and rebalance the hedge may actually be more restrictive for hedges with a basis risk than the 80–125 % threshold was. As one of the objectives of the project was to enable hedge accounting for economically defensible strategies that could not achieve hedge accounting under IAS 39, the “objective of the hedge effectiveness assessment” may be the cause the ED to fail in this perspective.

Far believes the “objective of hedge effectiveness assessment” criteria may to some extent be driven by anti-abuse considerations. This could for example be designating the hedged item to achieve a particular accounting effect such as avoiding over hedging. Far believe that such designation would not be in accordance with general risk management practice and discipline would be achieved by the requirement to disclose the objectives and strategies of the hedges for which hedge accounting is applied. Far believes that the situations where a one-to-one designation could be used to “hide” a speculative strategy may exist but are very limited and that on balance the complexity that arises from requiring the optimal ratio for all preparers is not motivated by the potential cases where the designation could be abusive. The Board should consider whether “the objective for hedge effectiveness assessment” is necessary or if it could be removed from the qualification criteria and be replaced by the guidance on designation that is currently in IAS 39.AG 107A.

Far believes that the proposal of prohibiting de-designation is not necessary since the potential for abuse is limited as de-designation can only be applied prospectively. De-designation and re-designation is also important for all dynamic strategies including macro-hedging. Far thus believes that prohibiting de-designation before addressing dynamic hedging or macro-hedging would potentially result in inconsistent standards or negatively impact the possibility of resolving the macro-hedging issues.

One proposal that Far does not agree with is the presentation of the effects of a fair value hedge and believes that retaining the presentation requirements from IAS 39 today is preferable to the proposed presentation in the ED. Presenting the gross numbers on the face of Other Comprehensive Income where the ineffectiveness is removed from OCI and moved to profit and loss would not add value to the users in proportion to the complexity added for the preparers. Far agrees that there would be benefits of disclosing the “pure” amortised cost

and the fair value adjustment of the hedged item separately as this would give a more clear understanding of the effects of fair value hedging since the information content of the amortised cost measurement is retained. Far believes, however, that it is more useful if presented in the disclosures rather than on the face of the balance sheet. The proposed presentation would increase the number of line items significantly, especially in the financial statements for banks.

Another proposal relating to the presentation of hedge accounting is cases where an entity hedges net positions as well as hedges single transactions or groups of gross items. The proposal for separate presentation will be misleading as it will give the impression that this is the full extent of the hedging activities undertaken. Furthermore for users the impact of a single line item will be difficult to interpret as some hedged transactions will be reported at the hedged rate and others at the transaction rate. Far is not confident that such an inconsistent reporting of the effects of hedging activities in the profit or loss will present the user with more useful information.

Many entities whose risk management strategy is to consider all the items of the group to be the hedged items believe that all items in the group should be reported at the hedged rate (both revenue and costs) and allowing entities to apply gross presentation would be more consistent with the objective of aligning hedge accounting with risk management activities.

In appendix 1 Far sets out its responses to the questions the IASB has raised.

Far

A handwritten signature in black ink, reading 'Göran Arnell'.

Göran Arnell
Chairman Far's Accounting Policy Group