

Sir David Tweedie, Chairman
International Accounting Standards Board
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09 March 2011

Dear Sir David

Re: Exposure Draft ED/2010/13 Hedge Accounting

Transnet Limited is pleased to respond to the exposure draft, ED/2010/13 Hedge Accounting (the 'ED').

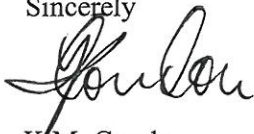
We support the efforts of the International Accounting Standards Board (IASB) (the Board) to align hedge accounting more closely with the risk management activities, establish a more objective-based approach to hedge accounting and address inconsistencies and weaknesses in the existing hedge accounting model.

However, we have concerns over some of the new proposals which we believe retain aspects of the rule-based approach that the IASB is attempting to change. In summary, our most significant concerns about the ED relate to the following items:

- The requirement for hedge items to affect profit or loss,
- Hedge accounting for net positions,
- Prohibition of voluntary de-designation of hedge relationships, and
- Accounting for fair value hedges.

Our detailed responses to the ED questions are included in the Appendix to this letter.

Sincerely



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Objective of hedge accounting

Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

We agree with the proposed objective of hedge accounting as this will help ensure that risk management rather than accounting rules drive management decisions around hedging.

We do however feel that entities manage business risks which (depending on IFRS rules) may or may not affect profit or loss but nevertheless have an impact on the financial position of the entity. As such we believe the IAS should allow hedge accounting for all risks that ultimately affect equity if that is the entity's risk management objective.

Instruments that qualify for designation as hedging Instruments

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

We agree that such instruments should be eligible for hedge accounting. Many entities make use of naturally offsetting economic hedges as part of their risk management strategy and hedge accounting for these hedges should be allowed provided they are effective hedges.

Derivatives that qualify for designation as hedged items

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?

Yes we agree with this proposal. However, we would like the IFRS to clarify how the derivatives that are part of the hedged item should be accounted for in the financial statements.

Designation of risk components as hedged items

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 (i.e. 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?

We agree with the proposal. The current position in IAS 39 where financial and non financial items are treated differently causes inconsistency between risk management strategy and hedge accounting.

Designation of a layer component of the nominal amount

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 with layered hedging as this generally reflects the commercial reality of risk management and offers greater flexibility in implementing hedge strategy.

- (b) *Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?*

We have not provided comment on this proposal.

Hedge effectiveness requirements to qualify for hedge Accounting

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 with the hedge effectiveness requirements. We however would like the IFRS to clarify the meaning of the words 'minimize expected hedge ineffectiveness' especially in cases where an entity has the choice of more than one hedge strategies offering different effectiveness levels and different costs to execute.

In addition, we would like more guidance in the IFRS in situations where hedges fail the prospective hedge effectiveness test due to the so called 'law of small numbers' where a hedge may appear ineffective due to small changes in the hedged item and hedging instruments over a period.

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 believe rebalancing should be voluntary rather mandatory, especially in instances where it may not be possible (for whatever reason) for an entity to rebalance the hedge at the time it first fails the hedge effectiveness requirements. The ED is also silent on whether a hedge that is ineffective for a particular period, but is ultimately expected to be effective over its life should be rebalanced.

- (b) *Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?*

We agree with this proposal.

Discontinuing hedge accounting

Question 8

- (a) *Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria*

(after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?

- (b) *Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?*

We do not agree that an entity should not be allowed to voluntarily terminate hedges, especially in situations where hedge accounting no longer provides any benefits. For example if a foreign currency denominated firm commitment is hedged with a FEC based on the expected cash flow date. Should the entity receive the invoice earlier than originally expected they may wish to stop hedge accounting for the firm commitment once it has crystallised into a recognized liability. Failing to do so would result in double counting (i.e. marking the foreign creditor to spot in accordance with IAS 21 and recognizing fair value changes on the firm commitment).

Accounting for fair value hedges

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 do not agree with this proposal as it may lead to costs associated with accounting systems changes for little if any additional benefit. The need to disclose all hedge accounting activities in the same place can easily and more cheaply be achieved through disclosure in the notes to the financial statements.

In addition, such changes will have an impact on the liquidity or profitability ratios of entities.

- (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 believe this disclosure can easily be made in the notes without cluttering the face of the statement of financial position with additional line items.

- (c) *Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?*

We agree with this proposal.

Accounting for the time value of options for cash flow and fair value hedges

Question 10

- (a) *Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (e.g. like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?*
- (b) *Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive*

income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?

- (c) *Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (i.e. the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?*

We generally agree with the proposals. However, we would like more clarity on why the IASB is moving in this direction as it effectively moves volatility arising from the time value of options from the income statement to OCI.

Question 11

- (a) *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 believe the requirement for cash flow hedges that “the group of hedged items exposed to the hedged risk affect profit or loss in their entirety in the same reporting period” should be dropped as it may not align hedge accounting with risk management objectives.

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 (e.g. 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 agree with this proposal. However, we would recommend that a (grossed up) breakdown of this separate line item be presented in the notes.

Question 13

- (a) *Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?*
(b) *What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?*

We generally support the proposals. We do however like to note that so of these disclosure requirements can potentially lead to disagreements with auditors over whether sufficient information has been disclosed. In addition, some information regarding future cash flows may be sensitive.

Question 14

Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

We support the proposals in the ED.

Question 15

- (a) *Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?*

(c) If not, which of the three alternatives considered by the Board in paragraphs BC226–BC246 should the Board develop further and what changes to that alternative would you recommend and why?

We have not commented on this proposal.

Question 16

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

We agree with the proposed transitional provisions.

Other comments

Hedge Accounting for Foreign Currency Risk on Bonds

Under the current IAS 39, it has been difficult to apply hedge accounting for foreign currency risk arising on bonds (and similar instruments) for the period before they are recognized in the financial statements. For example, a foreign currency denominated bond may be issued / priced on t+0 but settlement (and recognition of the liability) only takes place five days later (on t+5).

While the entity has a genuine exposure to foreign currency risk between t+0 and T+5 which it may seek to hedge, hedge accounting for this risk is prohibited due to the fact that any exchange gains or losses before the bond is recognized will not affect profit or loss even though this is in line with the risk management strategy.

We would appreciate if the new requirements were to allow for hedge accounting under these circumstances and give guidance on how this would work in practice.