

March 9, 2011

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

Subject: Comment letter on the exposure draft on Hedge accounting

Dear Sirs,

Bombardier welcomes the opportunity to provide comments to the International Accounting Standards Board on the December 2010 Exposure Draft on Hedge accounting (the 'ED').

We are a Canadian world-leading manufacturer of innovative transportation solutions. We operate under two broad manufacturing segments: aerospace and rail transportation. We generate 95% of our revenues outside Canada, with a global workforce of 63,000 employees and 68 production and engineering sites in 23 countries and a worldwide network of services centers.

We support the Board's efforts to create an accounting standard that aligns hedge accounting more closely with risk management and establishes a more principle-based approach to hedge accounting. However, we believe that the proposal does not achieve this objective as certain rules seemingly introduced to adhere to the stated principles will prevent the alignment of hedge accounting to an entity's management of exposures arising from particular economic risks.

Our risk environment

Both of our operating segments, Bombardier Aerospace (BA) and Bombardier Transportation (BT), are exposed to significant foreign exchange risks arising from forecasted cash flows in multiple currencies.

BA is a manufacturer of aircraft and provider of related services having the US dollar as its functional currency. Sales and purchases are recognized in P&L upon delivery of aircraft or when services are rendered. The manufacturing of an aircraft can take up to two years. BA's operations are mostly located in countries where the legal tender currency is other than the US dollar giving rise to large exposures to expenditures in foreign currencies (including salary costs and pension contributions). Most of its sales are denominated in US dollars but a portion is denominated in foreign currencies.

BA manages its net FX exposure through a central treasury center by entering into forward foreign exchange contracts to purchase foreign currencies for up to 85% of its net exposure to these currencies in a given period. The net FX exposure consists of expenditures in foreign currencies, partially offset by sales and the receipt of government assistance in the same

currencies. In order to meet the hedge accounting requirements under IAS 39, the designated hedged exposures are the first dollars of a group of gross exposures (expenditures in foreign currencies) corresponding to the net FX exposure to be hedged. Although the risk management strategy and the accounting designation are not aligned, this approach is efficient as it reduces the cost of hedging with the market by entering into derivatives that hedge only the portion of the net exposure for which coverage is required under the strategy and yet achieving hedge accounting under IAS 39.

BT is a manufacturer of trains and provides related services. Sales and purchases are recognized based on the percentage-of-completion method of IAS 11 (i.e. based on the stage of completion of the contract). Typical train manufacturing and servicing contracts can be very large (multi-billions of dollars) and are performed over extended periods of time of up to 5 years, and even longer for service contracts. BT has significant exposures to foreign currencies arising from more than a thousand contracts having sales and purchases in multiple currencies since its operations are carried out in more than 70 countries.

BT currently manages its FX exposure through a central treasury center on a gross basis, contract by contract (its practice is to hedge 100% of such exposure i.e. specific gross designation for each contract) although economically managing its exposure on a net basis would achieve both significant cost reductions and simplify the hedging process. The main reason for using a gross approach is to avoid the significant volatility that would arise in accounting for long-term contracts if stable exchange rates for all revenues and expenses in foreign currencies were not achieved. Such volatility would arise if either contract revenues or contract expenses were to fluctuate during the production/service period from changes in exchange rates due to the mechanic applicable to long-term contract accounting under IAS 11. Without the benefit of hedge accounting, cumulative catch-up adjustments would continuously have to be recorded under the IAS 11 rules as the impact of changes in the anticipated margin at completion and in the stage of completion must be recorded in P&L as they arise (each time exchange rates fluctuate, estimates of revenues and expenses in foreign currencies would have to be adjusted). In other words, calculating a margin at completion and the stage of completion using the spot rate for revenues and expenses means that cumulative catch up adjustments will have to be recorded every time a relevant spot rate changes until the forecasted cash flow is realized. Such adjustments would be very significant for BT due to the size of their long-term contracts.

Objective of hedge accounting (question 1)

We agree with the objective of hedge accounting to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks. If this objective could be comprehensively achieved, benefits for entities like ours would be significant, both in terms of reduced hedging costs and efforts to track and account for hedging activities. However, the ED fails to live up to this statement and we explain below the numerous issues that we see with the proposals and our suggested amendments to achieve this stated objective.

Hedged items - Groups of net positions (questions 11 and 12)

Significant economic benefits would be obtained if both of our operating segments could use their net group exposure for the purpose of transacting with the market (more than \$20 million of cost savings per year at BT). Also, the prohibition to the use of hedge accounting when the designation is not aligned with the risk management strategy, coupled with certain proposed rules contained in the ED, would result in additional hedging costs for BA. Unfortunately, the rules as currently proposed would not permit us to use a net group exposure as demonstrated below.

We understand that some prohibitions to the use of hedge accounting for net exposures (e.g. same period accounting and income statement presentation for the purpose of cash flow hedge accounting) lies with the fact that not all items of the net population are hedged and therefore it is difficult to account for the effect on hedges when changes in a net population occur (it would require subjective allocation of accumulated hedging gains and losses in other comprehensive income ("OCI")). These prohibitions will make hedge accounting on a net exposure almost impossible to achieve for entities like ours. In our view, the solution to this problem consists in assuming that the entire population giving rise to the net exposure is synthetically hedged (as if the entire population had been hedged on a gross basis). However, we understand that the Board members are concerned with the grossing-up of gains and losses that do not exist.

In our view, the management risk objective behind a net hedging strategy is to effectively hedge all revenues and expenses within the group while significantly reducing the cost of hedging. Furthermore, allowing hedge accounting for a group of net exposures necessarily implies the same view that each item of the group of transactions is synthetically hedged. For instance, in the case where an item of the hedged group of transactions ceases to exist prior to its forecasted occurrence, it will be necessary to recycle deemed gains or losses accumulated in OCI. This recycling implies that all elements of the group of items are effectively hedged. Such recycling could also be required in case of changes in the timing of an exposure in the group of items. The recycling of deemed gains and losses contradicts the statement from the Board regarding their unease with the grossing up of gains and losses. Again, we submit that it is proper to assume that each element of the group of items is effectively hedged as it generally aligns with hedging risk management objectives.

The view that each element of the offsetting group of items is effectively hedged is also supported in the ED, when a group of offsetting items is hedged for fair value risk. Effectively, in the case of a group of offsetting items hedged for fair value risk, all the offsetting items within the group should be re-measured on the balance sheet. Although this does not amount to grossing up the gains or losses on the hedging instruments, it implies that the offsetting hedged items in the group are actually eligible hedging instruments of one another. For instance, a fixed-rate asset of 30 and a fixed-rate liability of 50 are hedged as a net position with a received fixed, pay variable interest rate swap of 20. Under the ED, the interest risk component of both the asset of 30 and liability of 50 will be re-measured in the balance sheet (through OCI with ineffectiveness recorded in P&L). This means that, in effect, the asset and liability are considered as hedging instruments of one another. We submit that it is proper to assume that each element of the offsetting group of items is effectively hedged irrespective of the type of hedge, i.e. fair value hedge or cash flow hedge.

If the prohibitions to the use of hedge accounting for net exposures have been introduced also to ensure that sufficient information is available to support proper accounting for hedging activities, we submit that this limitation is not necessary (and not aligned with a principle-based approach). For instance, each division of the BT segment is responsible to identify and document their FX exposures and to enter into internal derivatives with the central treasury center. The central treasury center is then responsible to enter into offsetting derivatives with the market. We have set up systems and processes that allow us to track the impact of changes in a group of hedged cash flow exposures. Our database of gross exposures (both outflows and inflows having internal trades) is updated every reporting period. In doing so, we ensure that we are able to properly identify individual changes in a group of cash flows (whether hedged on a net or a gross basis) and to reflect the impact of a change in the exposure arising from any individual items in accordance with the proposed hedge accounting rules.

In summary, we believe that allowing hedge accounting on a net exposure basis would be a tremendous improvement in achieving the aim of aligning the accounting to the risk management strategy. In our view, the best way to achieve such result is to assume that all items of a net population are effectively hedged, irrespective of the type of hedge. Without such assumption, hedge accounting on a net basis would be virtually impossible. If the Board is not willing to follow our suggested approach, the ED proposal will end-up being worst than the current rules. This is because it would force many entities to totally discard a net exposure strategy because it would not be possible to meet the proposed hedge accounting requirement for the purpose of cash flow hedge accounting. It would again forces entities to adopt a risk management strategy (a gross approach) to match the requirement of hedge accounting while the disclosed objective of the ED is to align the accounting with the risk management strategy. We believe that accounting rules should only be designed to depict the economic activities of an entity, not to drive economic behaviors. In this sense, the current rules of IAS 39 are even better than those proposed (although quite deficient in our view) as they provide management with some flexibility to manage FX exposures on a net basis.

1. Same period accounting (question 11)

We do not agree with the criterion that all items must affect the P&L in the same reporting period for group of items that constitute a net position in a cash flow hedge relationship.

As explained above, our risk management strategy consists in managing as a group our exposures from forecasted cash flows in foreign currencies. Since the ultimate economic exposure of both segments arises from such forecasted cash flows, our strategy consists in hedging the cash flows and not the related P&L components (i.e. the relevant timing criteria is when cash flows arise). Therefore, the same period P&L requirement is not aligned with how we currently manage our foreign currency exposures.

In the case of manufacturing companies, hedging exposures to purchases in foreign currencies would imply that accumulated gains and losses on hedging instruments are released from OCI to inventories at the time of purchase (ED requirement for cash flow hedges). Such gains and losses will only find their way to the P&L upon the sale of the underlying product. In the case of revenues in foreign currencies, the cash inflow in foreign currency and the recognition of revenues may or may not be recognized in the P&L in the same period. Therefore, for a pool of

offsetting exposures arising from sales and purchases in foreign currencies, the same period accounting requirement to qualify for hedge accounting will not be met. For example at BA, cash in foreign currencies may be received/paid in connection with sales and expenditures related to current expenses, inventories, property, plant and equipment (PP&E) and deferred development costs. Although such cash payments may occur in the same month, expenditures related to current sales and expenses will be recorded immediately in the P&L, while inventory related purchases will be recorded to P&L only when the aircraft is delivered, and disbursements related to PP&E and deferred development costs will affect the P&L as these assets are amortized over many years.

In our view, the same period P&L requirement will prevent most manufacturing entities from aligning hedge accounting with an entity's risk management activities, in particular those having a manufacturing process extending over long periods of time.

Finally, any requirement based on the "same period" concept will run against the subjectivity of the determination of the underlying periods. For example, if an entity is reporting quarterly, the period will be three months while it will be 12 months for an entity reporting annually. We submit that this is so rule-based that it can only be flawed.

We therefore submit that the criterion to have a P&L impact in the same reporting period should be removed. We don't see any compelling argument to impose this limitation but we see significant negative consequences in retaining it. In our view, as long as the accounting processes allow for the tracking of information that allows for proper accounting for the effect of hedges (basically to ensure any inefficiency is recorded to P&L and gains and losses are properly recycled out of OCI), hedge accounting should be allowed.

2. Income statement presentation (question 12)

The presentation of the impact of hedging activities on a separate line item on the P&L in situation of net hedging implies that the underlying revenues and expenses in foreign currencies should be presented at the spot rate instead of the hedged rate. We believe that this requirement will create an impediment for most manufacturing entities hedging exposures to revenues and expenses in foreign currencies from using a net exposure approach, in particular for entities accounting for their long-term contracts under IAS 11.

i. Impact on accounting for long term contracts

The presentation of offsetting sales and cost of sales at spot rate as if there was no natural offsetting of exposures (i.e. excluding the effect of effective hedges positions) would require us to run systems related to long-term contract accounting with volatile estimates of sales and costs. This in turn would give rise to multiple and recurring cumulative catch-up adjustments recorded in P&L since the change in the amount of forecasted revenues and expenses would not offset in the P&L even if they are of the same offsetting magnitude. This is caused by the determination of the percentage of completion of the contract which is measured solely by comparing costs incurred to date to the total costs to be incurred until completion of the contract. Also, in the case of a contract with FX exposure to multiple currencies, the ultimate margin on the contract would fluctuate as changes in exchange rates occur, despite that the exposures are economically hedged. Also, we are concerned as to how such adjustments would

be measured with existing systems and processes as it would require isolation of the impact of the changes in exchange rates that would introduce significant complexity to already complex processes.

In addition, we believe that this requirement would introduce significant volatility in individual line items on the income statement that will impair the decision usefulness of the information and will disconnect the reporting from the risk management strategy. As mentioned above for most entities exposed to FX fluctuations, this strategy consist in hedging 'all' exposures in a given population and then, as a mean to achieve this strategy in a cost effective manner, to hedge the net exposure only with external parties.

If another concern of the Board in introducing this limitation is to ensure that the effect of hedging activities is properly and timely reflected in the P&L, we submit that this limitation is not necessary, as explained above, and the Board should rather adhere to the basic principle of requiring a proper matching of the impact of effective hedging activities in the P&L.

ii. Decision usefulness

As we operate in multiple countries, sometimes where the functional currency of the operating entity is not the local currency, our exposures to foreign currencies affect different line items in the income statement, such as revenues, cost of sale and selling, general and administrative, research and development and net financing expenses. The proposition of the ED for hedging a group of exposures on a net basis in cash flow hedge relationships implies that all hedged items will be presented at the spot rate in the P&L with the effect of hedging activities presented on a separate line item, creating a departure from the current practice without corresponding benefits. When multiple line items of the income statement are subject to hedging activities, the ED proposal will create numerous volatile line items and potentially distorted key financial indicators and ratios, such as margin and EBIT. We submit that this requirement will make the income statement cumbersome as it will add complexity to the income statement which in our view will not properly portray the economic activities of the entity. For instance, when we bid for long term contracts, our pricing decisions are governed by the anticipated revenues and costs that will arise after giving effect to hedges. Presenting a margin that is not aligned with the economics of the underlying bids reduces the decision usefulness of the income statement. We therefore propose to recognize the effect of hedges in the corresponding hedged line item as this will remove this issue.

Qualifying hedging instruments (question 2)

The ED proposes that only external hedging instruments should be permitted in a cash flow hedge relationship. In the context of operationally decentralized operations, we believe that intra-group derivatives should also be permitted hedging instruments on a consolidated basis, when the exposure arises from changes in FX rates.

From our reading of the basis for conclusion in connection with the restriction in the use of internal derivatives, we do not see any compelling arguments to support the exclusion of internal derivatives to hedge specific FX exposures.

Our risk management strategy consists in eliminating exposures between our reporting segments with internal trades and only hedging the remaining net exposure with the market, if

any. Under the ED proposal, we will not be able to align our accounting reporting to our risk management strategy (which is also the case today).

The Board noted that any transfer of risks within the reporting entity does not change the risk exposure from the perspectives of that reporting entity as whole. We agree with this statement but we also note that the ultimate risk of the consolidated entity is the net exposure (i.e. there is an effective offsetting of risks on a consolidated basis) and it is only this ultimate risk exposure which should be subject to the hedging requirement with an external party. We also note that the only purpose of hedge accounting is to ensure proper matching of gains and losses on corresponding hedging instruments and hedged items. In this context, hedge accounting should align with the hedging strategy of an entity which is to take opportunities of intra-group offsetting positions (i.e. intra-group hedge accounting should be allowed in these circumstances). In this manner, the timing of gains and losses recognition amongst individual reporting entities would be retained in the consolidated financial statements of the group.

Failure to allow hedge accounting in the circumstances described above would often forces entities to hedge their exposure on a gross basis by entering into costly external trades for each leg of the transaction (i.e. revenues and expenditures). This is because the timing of forecasted transactions that can be hedged between two reporting groups may be the same but the corresponding P&L impact could be quite different and therefore allowing internal derivatives as qualifying hedging instruments would allow proper matching of gains and losses on the P&L. For example, a subsidiary sells a product in foreign currencies for which the payment will be received in 12 months and revenue recorded in the same month. Let's also assume that the internal counterparty purchases products for the same amount in the same foreign currencies also in 12 months. In this case, the purchases would be recorded in inventories and stay there until the goods are sold. If an entity has a risk management strategy to hedge the exposure to foreign currencies for each operation using an internal trade, disallowing such instrument for hedge accounting on a consolidated basis will create an accounting mismatch as the economic exposure arises at the same time but not the impact in the P&L. This is the main reason why internal trades should be allowed as qualifying hedging instruments. The ED does not properly address economic transactions such as those described above and this is a crucial concern for us as cost saving related to internal hedging strategy can be very significant (approximately \$10 million of cost savings per year).

We also submit that our proposed accounting method would be consistent with the IAS 21 accounting rules where FX gains or losses on intercompany exposures arising in entities of a consolidated group are retained at the consolidated level (i.e. there is no re-measurement based on a consolidated views).

Limitation in the application of hedge accounting (question 1)

As already stated, we have mainly exposures to forecasted revenues and expenses in foreign currencies. However, we have identified economic exposures to other forecasted foreign currency transactions as well as from investments in foreign currency classified as available for sale, for which gains and losses are recorded directly in OCI and never recycled to P&L. In these cases, hedge accounting is not available under the ED proposals. The limitation to the application of hedge accounting only to items that affect the P&L is therefore not aligned with

how entities manage their FX exposure and therefore not in line with the primary objective of the ED.

Allowing hedge accounting only to items that could affect P&L implies that when an entity records actuarial gains or losses related to pension activities directly in OCI (which are never recycled to the P&L), hedge accounting for the funding of the corresponding deficits would not be allowed. We currently have significant pension deficits in foreign currencies and we have an economic exposure to foreign currencies for the funding of these deficits that can be very significant (net deficit of \$1.7 billion with funding requirement of \$400 million per year, mostly in foreign currencies). We economically hedge a portion of the future funding requirements in foreign currencies. If hedge accounting is prohibited in these circumstances, it will maintain not only volatility in the P&L but the recognition of gains and losses on hedging instruments (forward contracts in this case) that will be unmatched by the offsetting losses and gains on the hedged exposure. Therefore, a genuine hedge program, the purpose of which is to reduce an entity's economic exposure to changes in FX rates, will be portrayed in the financial statements as speculative activities. This restriction disconnects hedge accounting from the entity risk management activities, which again contradicts the main objective of the proposed rules.

We submit that extending hedge accounting to items that impact only OCI is not substantially different from allowing hedge accounting for net investment in a foreign operation. This is because in many instances, investments in foreign operations are quasi-permanent in which case accumulated gains and losses on related hedging instruments will end up being permanently recorded in OCI. Although we understand that these two situations are conceptually different (the gains and losses in connection with foreign operations could eventually be recycled to P&L), we believe that in practice the results are very similar.

Accordingly, we disagree with the requirement that the particular risk to which we are exposed should affect the P&L in order to qualify for hedge accounting.

Measurement of hedge effectiveness (question 6)

We believe that the requirement to measure hedge effectiveness at present value is appropriate in most instances. However, when the designation of the hedge relationship is based on the spot rate, we believe that this requirement is inappropriate in the context of future cash flows in foreign currencies.

BT uses rollover strategies to hedge its exposure from forecasted transactions in foreign currencies by which forward contracts with short term maturities are used to hedge long term exposures. The forward contracts are rolled over until the forecasted transactions occur. This strategy is highly effective when the spot rate is the hedged risk. Often there will be no efficient alternative to this strategy as forward contracts are often not available for long term exposures to foreign currencies. For example, if we have an exposure that arises in 36 months, we may enter into a forward contract with a 12 month maturity. After 12 months, we will rollover our position for another 12 months, or a shorter period, until the exposure to the hedged risk disappears. Using the spot designation means that there is no ineffectiveness to record in P&L as both elements of the hedging strategy are valued at spot rate. The interest component (the forward points) is not part of the hedging strategy and therefore they are mark to market at each reporting periods with gains and losses recorded directly to P&L. Recognizing hedge

ineffectiveness due to a present value methodology in such circumstances will create volatility (12 month derivatives vs 36 month exposures) relating to an interest element. Since the interest element has been excluded from the hedge relationship, it should also be excluded from the assessment of effectiveness.

Designation of hedging instruments

The ED proposes that hedging instruments must be designated in their entirety in a hedging relationship except for the interest element of a forward contract and the time value of an option contract. These two exceptions are permitted to be excluded from the hedging relationship because the intrinsic value of the option and the premium on the forward contract can generally be easily measured separately.

We believe that the credit risk element of the counterparty in a forward contract and in an interest rate swap or cross-currency interest rate swap can also be easily and reliably measured separately. Effectively, the fair value of derivatives must take into consideration the credit risk of the counterparty. In practice, the fair value of derivatives is determined first by measuring the value of a derivative solely based on current market data excluding the credit risk of the counterparty. Then the credit risk element is added to this value in calculating the fair value. Therefore, the credit risk element meets the definition of easily and reliably measurable separately. Adding an exception for the counterparty credit risk element will simplify the hedge effectiveness assessment as any fluctuation in the credit risk of the counterparty necessarily causes ineffectiveness as credit risk is not part of the measurement of the hedged item. It should be noted that the credit risk will still be measured and recorded in the P&L under the proposed rules even if it is not included in the assessment of hedge effectiveness. Also, the counterparty credit risk would still need to be continually monitored to ensure that the hedging instruments are still qualifying instruments.

Discontinuance of hedging relationship (question 8 b)

The ED proposes 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.

We generally agree with this proposition; however we believe that an exception should be introduced for practical purposes. The situation we have in mind is when an entity hedges an FX exposure to a forecasted transaction (e.g. a purchase) which is later recorded on the balance sheet (e.g. a trade account payable) before it is realized. In these circumstances, it is often more cost effective to dedesignate a cash flow hedge relationship of a forecasted transaction (no need to continue tracking the related exposures and to assess and evaluate the effectiveness of the relationship). When the forecasted transaction (purchase) becomes on-balance sheet (account payable) gains or losses on FX hedging instruments will be naturally offset in the P&L by losses or gains from the revaluation of the corresponding balance sheet item.

We therefore suggest that voluntary discontinuation should be permitted for a hedging relationship that still meets the risk management objective and strategy when the exposure arises from a balance sheet item in foreign currencies revalued to P&L at each reporting period.

Disclosures requirements (question 13)

We agree with the disclosure objective as defined in paragraph 40, including a description of the risk management activities and strategies. However, we are concerned with the increasing volume of disclosure requirements and with the fact that these new disclosures will provide commercially sensitive information. These new disclosure requirements seem to add to the already existing disclosures in IFRS 7 related to hedge accounting. If disclosures become overly voluminous readers may have difficulty to understand all of the information presented in the financial statements and to obtain a clear view of what is most important. We propose to limit the disclosures to items necessary for the understanding of our risk management activities and strategies as defined in paragraph 40. Therefore, we would encourage the Board to consider how the proposed disclosures will interact with the existing hedge accounting disclosures in IFRS 7.

Please do not hesitate to contact the undersigned if you wish to discuss our comments with us.

Best regards,

Signed in Montréal: Jean Paré

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