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Dear Sirs

**Exposure Draft: Hedge Accounting (ED/2010/13)**

We are grateful to have the opportunity to comment on the IASB's Exposure Draft "Hedge Accounting".

Overall, we support the change from IAS 39 to a more principles-based approach to hedge accounting and the proposed simplifications in hedged items and testing hedge effectiveness. These changes benefit entities such as Unilever by aligning the hedge accounting with the commercial hedging activities. However, we do not support all of the changes, particularly those around disclosure, as explained in our detailed answers.

The Exposure Draft has introduced significant modifications to existing rules and a number of new concepts such as rebalancing. We are concerned that entities will not understand these modifications or apply them on a consistent basis.

In order that the IASB's intentions and entities' interpretations are consistent, we recommend that the IASB conduct further field-testing and outreach activities prior to finalising the Exposure Draft.

Our more detailed answers attached to this letter address these points and others. If you wish to discuss any of the views, please contact me in writing.

Yours sincerely

PB Balaji  
Group Chief Accountant

**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?**

*Response:* Yes – we agree that hedge accounting should reflect risk management activities in order to provide more relevant reporting. We support a more principles-based approach to hedge accounting.

Having a principle in place gives preparers and users a reference point when considering the accounting for financial instruments, including those which are more complex.

The principle should also improve the alignment between risk management activities and financial reporting by aligning the hedge accounting with the commercial hedging activities.

**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?**

*Response:* Yes – we support the aggregation of exposures but only when they are actually managed from a risk management perspective as a single item. This is consistent with the objective of hedge accounting and aligns risk management activities and financial reporting.

**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?**

*Response:* Yes – we support the use of components as a hedged item but only when they are managed from a risk management perspective as components. This is consistent with the principle of the exposure draft and aligns risk management activities and financial reporting.

For example, aluminium is significant raw material in the manufacture of aluminium cans used for aerosol sprays which are purchased by Unilever. Currently, Unilever would like to hedge the aluminium component but IAS 39 does not permit this. The proposals in the exposure draft would make this possible. In our view, this is an essential part of the new proposals: it makes it easier for entities to achieve hedge accounting when the entities are actively managing the risks.

We consider that the criteria of being separately identifiable and reliably measurable are also appropriate.



**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?**

*Response:* Yes – we support the introduction of the layers as a hedged item but only when they are managed as a single item from a risk management perspective. This is consistent with the objective of hedge accounting and aligns risk management activities and financial reporting.

**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?**

*Response:* We support the removal of the bright line hedge effectiveness test of 80% to 125%. The bright line approach is arbitrary and is not consistent with the risk management objectives for preparers in general. It also means that some companies do not enter a commercial hedging arrangement because of a lack of certainty over whether hedge accounting would be achieved throughout the life of the hedge. In our view, this is an essential part of the new proposals since it brings the hedge accounting into alignment with entities' risk management activities.

However, we recommend that additional clarification is provided with regards to the definition of 'unbiased result' and 'accidental offsetting' so that these definitions are interpreted and applied consistently.

**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?**

**(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?**

*Response to Q7a:* Yes – in order to apply hedge accounting, a hedge relationship should continue to give an unbiased result and achieve offsetting. If this requires rebalancing, then it should be mandated.

*Response to Q7b:* Yes – we support the approach of rebalancing prospectively, ie before ineffectiveness actually arises. Ineffectiveness up to the point of rebalancing should be recognised in the income statement.

## 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?**

*Response to Q8a:* Yes – we agree that hedge accounting should only be discontinued when it is no longer consistent with the hedge accounting objective.

*Response to Q8b:* Yes – we agree that voluntary discontinuation of hedge accounting should not be permitted when a relationship still meets the hedge accounting objective. We note that in practice, an entity will typically discontinue hedging and hedge accounting through closing out a hedge instrument earlier than the contracted end date.

## 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?**

**(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?**

*Response to Q9a:* Yes – we support the proposals for increasing the consistency of the accounting for cash flow hedges and fair value hedges.

*Response to Q9b:* No – we do not believe that gains or losses on hedged items should necessarily be presented separately on the face of the balance sheet. We strongly believe that the primary statements should be clear to a user and not unnecessarily detailed.

There is no doubt that this should be disclosed in financial statement but for many entities, such as Unilever, disclosure in the notes to the financial statements is sufficient. For companies in the banking sector, the disclosure on the face of the balance sheet may be more appropriate and we feel IAS 1 already covers such situations.



**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?**

*Response:* Yes – we support the grouping of hedge items as a single hedged item but only when they are managed as a single item and this is consistent with risk management activities. This is consistent with the hedge accounting objective and aligns risk management activities and financial reporting.

**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?**

*Response:* No - where there is a hedge of a net position, we believe that net presentation on a single line of the income statement is appropriate. This avoids grossing up balances in the income statement when they are actually managed together.

**Question 13:**

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

*Response to Q13a:* We support the disclosure of the entity's risk management strategy and the effect of hedge accounting on the primary statements.

However, we disagree with the prescriptive nature of the proposed disclosures around the amount, timing and uncertainty of future cash flows. We are concerned about the level of specificity prescribed and especially the commercial sensitivity of some of the information which may be required to be disclosed.

In our view, the level of disclosures about future events represents an inappropriate step change in the nature of forward-looking statements. This is onerous to prepare and must involve aggregation for large and complex entities like ourselves although in certain instances, this aggregation does not seem to be allowed. The detailed disclosure is not desirable from a commercial perspective and may not be valuable to the user because it may give a false impression of the actual future cash flows.

We support the principles of paragraph 43 and 44 and believe these principles are sufficient for entities to prepare accounts, without the requirement to mandate detailed disclosures.

**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?**

*Response:* Yes – we agree that there is currently an accounting mis-match where an entity has a portfolio of derivative contracts which can be settled net and 'own-use' contracts which are not accounted for as derivatives.

The proposed simplification permitting the 'own-use' commodity contract to be designated a derivative will allow such portfolios to be accounted for consistently. Entities may seek to apply this decision on a contract-by-contract basis if this is consistent with the risk management activities.

**Question 16: Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?**

*Response:* We believe that the amended standard should apply prospectively. Whilst this sacrifices comparability in the initial periods of application, the complexity of and judgement involved in a restatement would be onerous and we do not think it would provide value to the user of financial statements. We note that it would also be inconsistent with the Exposure Draft's proposal of assessing hedge effectiveness on a prospective basis.

The exposure draft proposes to permit early adoption of hedge accounting as long as IFRS 9 is also full adopted. We have two concerns: ongoing lack of alignment with risk management activities and comparability within the EU.

Currently, an entity's hedge accounting is not always aligned with their risk management activities and the Exposure Draft proposes to improve this. This is an appropriate and important change in IFRS and should be available for adoption as soon as possible.

The hedge accounting chapter of IFRS 9 is the only chapter that is proposed to be adopted prospectively, without prior year restatements. We recommend that this chapter should be the only chapter that can be adopted earlier than the rest of IFRS 9. With no restatement, this could be implemented without significant effort and quickly allow entities to benefit from the improved accounting if they wanted to.

Secondly, there may not be comparability amongst international preparers as entities within the European Union must wait for endorsement of standards for use in the EU. The effective date and option to early adopt should therefore allow sufficient time for the EU endorsement process to be completed before the proposed transition date.

In our response to the request for views on effective dates and transition methods, we proposed that the earliest transition date for IFRS 9 was 1 January 2015. This time is

necessary to allow all of the new or amended standards to be understood, systems changed, and training prepared and delivered.