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Comment letter to the Exposure Draft ED/2010/13 „Hedge accounting“

Dear ladies and gentlemen,

I appreciate the opportunity to comment the draft standard concerning the hedge accounting. The comments expressed herein are solely my personal views and strictly do not reflect those of any I have been working for. The comments are based on my experience as employee and in advisory with companies in the area of trade, industry and services.

Answer to question 1:

I agree to the objective of the standard because par 1 sets an exact introduction to the core idea of the new hedge accounting.

Answer to question 2:

The instruments qualify for designation as hedging instruments are extended in the way that all financial assets and liabilities at fair value can be used; according to IAS 39 only derivatives were allowed. The designation for currency risks remain the same.

It is important that all valuation at fair value have an objective background - at best an official listed price. Fair values that come from modelling should not be used for hedge accounting because the valuation results in a frame of values. The standard should go in more detail which sources for finding the fair values should be used.

Answer to question 3:

First the combination of a derivative and another asset or liability as a hedged item enlarges again the opportunities for and balancing company and the complexity. For non-financial industry I think there is no real need for this opportunity.

Answer to question 4:

Price formulas often include risk components for example energy contracts include commodity prices for calculation of the actual price. Designation of risk components can be useful to cover this specific price structure.

For objective and comparable accounting and identification of fair values it seems to be important that only risk components are hedged that are identifiable and reliably measured. In this respect the standard should point out that listed prices are needed to value the individual risk component to have reliable result. This seems easy to realize for currency rates but because non-monetary items are included in the hedged items this question should be regarded more closely.

Answer to question 5:

The designation of a component of a nominal amount I do agree to. The currency risk of secure amount of a forecasted transaction can be hedged this way.

Answer to question 6:

Hedge effectiveness must be given if a hedging strategy is implemented and used. This makes hedge effectiveness according to par 19 a qualifying criterion. Only if the documentation of hedging and hedged instrument, risk, assessment and determination of hedge ratio is given there can be a hedging relationship. Therefore it is still necessary to define what should be the hedge effective ratio because it is the line to find out if the company has to rebalance the relationship. The standard should give a line because otherwise in practise the old frame of 80%-125% will be used again.

Answer to question 7:

a. Rebalancing can adjust the value development of the hedging item and the hedged item. This is sensible to ensure the hedging relation but it should be regarded that the company not only acts in respect of reporting dates the relationship but in respect to the whole period.

b. Proactively rebalancing should be allowed because this is what risk managers do; if the standard should be in line with the hedging strategy the conclusion is to allow proactive rebalancing.

Answer to question 8:

a. The discontinuation of the hedging relationship only if the qualifying criteria are not

going to be ensured is in line with par 23. Otherwise the systematic rules for a hedging relation are not intact because the risk strategy can be rejected by individual single decision.

b. According to the reason given in 8 a. the living hedging relation should stay in place until the criteria are not met any more or expire. Anything else is a contradiction to the standards commented before and introduces individual decision making.

Answer to question 9:

a. I do agree because all hedge accounting valuations are combined in one place. Profit and loss extensions can be avoided.

b. Yes, the separate line in the statement of financial positions makes it easier to understand the impact of hedging.

c. Linked presentation is not so easy to understand. It is easier to show the economic effect straight on the statement of positions.

Answer to question 10:

A further separation of the time value seems to be very complex. The clear separation of intrinsic and time value is given up.

Answer to question 11:

IAS 39 has only accepted to designate a net position of a portfolio as a hedge item. The proposed regulation does not define the group asset and liability structure that can be hedged. This fact together with the opportunity to rebalance hedging relations rises the risk that great portfolios are combined according to an individual company risk strategy that are recalculated and rebalanced for a specific reporting time. The group of portfolios should be defined clearer. It would be useful to define a time line not only for the currency risk only.

Answer to question 12:

I do agree to the proposal because a clear view is given in the reporting that strengthens the need for consequent hedge accounting.

Answer to question 13:

The disclosures are generally in line with the other regulations. It is especially important to make disclosures about the risk strategy because it is in the middle of hedge accounting. Disclosure 49 a, b and 52 b should be proofed if they are already given by IFRS 7.

Answer to question 14:

The scope of IFRS 9 is widened again in comparison to IAS 39 because IAS 39 includes forward commodity contracts only if further regulations beside the fact of net settlement are met. Only if regulation 39.6 b) or c) are met a derivative is in place.

The proposed regulation should answer this question clearly. If the only criteria is the possibility of net settlement nearly all forward contracts can seen as a derivative. What does it mean that it "can be settled net cash". Has the company already acted this way in the past. Should it be agreed in the contract. Is it likely to happen. This should be handled in the standard text.

Additionally it should be clear if there is still an own use exception or not. This exception is useful for producing companies because it sets the focus on the extraordinary "trade" activities and not on the purchase of production material.

Answer to question 15:

I think there are 2 general alternatives: one unique standard for all companies concerning hedge accounting or the establishment of a specific standard for specific companies that use this standard. I think for comparison and development and understanding of accounting it is generally useful not to differentiate the standards more and more to branch specific accounting. In this respect I do agree that alternative treatments are unnecessary.

Answer to question 16:

I agree to the time frame because the interested companies have regarded the discussion about IFRS 9 for some time and it seems to give enough time for preparation - even for 2012 as comparing values for 2013.

Thomas Nolte