

## **Comments of The Institute of Chartered Accountants of India on the Exposure Draft on 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?**

#### **Response:**

Yes. Since it captures the risk management objective of the entity in accounting.

### **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**

#### **Response:**

Yes. As the objective is to manage the risks in more appropriate manner, any financial assets or financial liabilities should be available as hedging instruments.

### **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. A derived exposure, i.e., a non derivative exposure combined with a derivative exposure can be treated as a hedged item, as it also represents economic exposure which may have to be managed in a real life situation.

### **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?**

#### **Response:**

We agree with the proposal. It may, however, be useful if some guidance is provided as to when the risk component is to be considered separately identifiable and reliably measurable.

### **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?**
- (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?**

**Response:**

- (a) We agree with the proposal.
- (b) No, the existence of the pre-payment option should not preclude hedge accounting. However, the pre-payment option / the effect of the pre-payment option for the layer designated needs to be factored into the valuation / effectiveness assessment.

**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:**

Yes. Since it removes the arbitrary bright line rules that previously existed.

**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?**

**Response:**

Yes. However, this can be effectively implemented only when an entity has clearly defined risk management objectives and these are applied consistently without compromises.

Repercussion of not complying with the mandatory rebalancing is not covered by the ED e.g. whether the entity will be restricted from applying hedge accounting in future (akin to a tainting rule)

- (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:**

Yes. Principally we are in agreement with the suggestions.

**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?

**Response:**

We agree with the proposal.

- (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:**

Yes, as allowing discontinuation will not be consistent with the entity's risk management objectives.

**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?

**Response:**

Since Indian Accounting Standards (Ind ASs) prescribe the single statement approach this manner of presentation will have no material impact. However, we agree with this proposal for the reasons mentioned in IN30.

- (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:**

Yes. This would better reflect the valuation adjustment and operationally not get mixed with the amortised cost presentation.

- (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?**

**Response:**

Yes. Linked presentation is against the principles of off-setting and will not result in an appropriate presentation.

#### **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?**

**Response:**

We agree with the proposal.

- (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?**

**Response:**

We agree with the proposal.

- (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?**

**Response:**

We agree with the proposal

#### **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, offsetting items are hedged in practice on a net basis. The proposed rules are in line with current risk management practices.

**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?**

**Response:**

Yes, presentation in a separate line item would be more appropriate. We believe that grossing up of gains and losses would result in recognising notional gains and losses that do not exist (albeit offsetting in nature) and would not be a faithful representation of actual transactions undertaken. In addition, such a gross presentation could result in unanticipated effects such as purchase costs and in turn on inventory valuation etc.

**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:**

We agree with the proposed disclosure requirements

**(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?**

**Response:**

No additional disclosures proposed. The proposed level of disclosures itself is very comprehensive and poses significant implementation challenges.

**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, only in limited circumstances will this be appropriate. Adequate safeguards need to be provided to avoid this exception being misused.

**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?**

**Response:**

Yes, moreover this aspect is not relevant in India as no credit derivatives that are currently permitted to be undertaken.

**(b) 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?**

**Response:**

Not applicable as given the response to Question 15 above.

**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 agree with the proposed transition requirements.

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