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International Accounting Standards Board
30 Cannon Street
LONDON
EC4M 6XH

Dear Sir/Madam,

Re: Exposure Draft ED/2010/13 – *Hedge Accounting*

We welcome the invitation to comment on this Exposure Draft and write on behalf of Cobham plc, a UK based FTSE 250 and S&P Europe 350 company. We operate globally in the Aerospace and Defence sector.

The activities of the Group expose it to the financial risks of changes in foreign currency exchange rates and interest rates. The Group uses foreign exchange contracts and interest rate swap contracts to manage these exposures and does not use complex financial instruments or derivative financial instruments for speculative purposes. The Group has documented its risk management objectives and strategy for undertaking various hedge transactions, and currently utilises hedge accounting principles in relation to interest rate swaps. These are designated as cash flow hedges which mitigate the Group's exposure to changes in interest rates arising on floating rate debt. From time to time, the Group may also use interest rate swaps to manage its exposure to changes in the fair value of fixed rate borrowings, however there are no such contracts outstanding at the present time. Foreign exchange contracts entered into to mitigate foreign exchange impacts of trading in non-functional currencies are not accounted for using hedge accounting. Commodity price risks are not hedged.

We are generally supportive of the Board's project to reduce complexity in the accounting of financial instruments and in the context of this ED, to provide more useful hedge accounting information and to address the criticisms of IAS39 in this area. It is disappointing that the proposals do not address portfolio (macro) hedging but note that this continues to be discussed by the Board. Our preference would be for a more comprehensive standard on hedge accounting to be published rather than the piecemeal approach which has been taken.

Our responses to some of the specific questions in the ED can be found in the attached appendix.

Please contact Cathy Steger-Lewis or Steve Skinner if you need any further clarification in respect of these comments.

Yours faithfully,

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APPENDIX

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 believe it is important for the new standard to define an objective and that it is correct to relate this to the risk management activities that entities undertake, however we do not think it is correct to refer solely to risks that could affect profit or loss. Hedging activities may also be undertaken to manage the risks of balance sheet positions or cash flows as well as profit or loss impacts. Perhaps a more general 'financial statements' could replace 'profit or loss'.

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?

Yes we agree.

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?

We agree.

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?

We agree.

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?

- a) Yes, we agree. We find the rules in IAS39 restrictive especially when considering debt refinancing or restructuring and this would allow more flexibility and increased usage of hedge accounting.
- b) No comment as not applicable to our business.

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 removal of the bright line testing of hedge effectiveness and that, as noted in BC77, this was arbitrary and onerous to apply, and we agree that this had the effect of de-linking the accounting and the risk management strategy. However, whilst there do need to be some criteria for applying hedge accounting we do not believe that the hedge effectiveness requirements in the ED are defined or explained clearly enough.

As a start, the draft currently cross refers to the application guidance for definition of this test – as this is fundamental to the application of the standard, perhaps this should be included within the body of the main standard.

One of the problems with IAS39 was that the effectiveness testing was considered onerous – this is still the case for entities such as Cobham plc who do not have large treasury departments with sophisticated systems. We would urge the Board to re-consider these requirements from the viewpoint of the many entities not in the financial services sector who are currently required to follow rules which were basically written for banks.

Furthermore we note that the requirement is that the hedge reflects the optimal hedge ratio. We consider this to be a judgemental issue and are concerned that this could lead to debate with auditors over what is essentially the application of an entity's risk management strategy.

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?

- a) See comments above on the hedge effectiveness assessment – if this were revised then the rebalancing would not be necessary. It should be quite simple that over time, if the risk management objectives for the hedging relationship are the same, then the entity should be allowed to continue hedge accounting. Ineffectiveness will flow through profit or loss so it is unclear what rebalancing achieves other than adding complexity. We do not agree that rebalancing should be mandatory and that there should be some flexibility for entities who may determine that the hedge effectiveness has only changed temporarily or that the impact of rebalancing is not material.
- b) Subject to the above we agree with this proposal.

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?

- a) We agree.
- b) We disagree and believe that there are circumstances where the de-designation of hedges would more accurately reflect the risk-management objectives of the entity. Therefore we believe in certain circumstances it may be more appropriate to allow voluntary de-designation: the criteria for de-designation should be more focussed on risk management objectives and not upon the hedge effectiveness assessment. Consideration should be given to disclosure of the circumstances and facts surrounding the voluntary discontinuance.

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?

(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?

- a) We believe the proposed presentation for fair value hedges is overly complex and should not be mandatory. Entities should be allowed to decide how to best present this information in their financial statements so as to provide sufficient information to enable users to understand the effects of their risk management strategies and the impacts of hedge accounting on the results.
- b) We do not agree that a separate line item in the statement of financial position is necessary and think that this may be more fairly presented in the notes to the accounts, dependant upon circumstances. We believe that this is adequately dealt with in paragraph 77 of IAS1, allowing an entity to determine which items are disclosed where. Paragraphs 51-53 of the staff draft of the ED on Financial Statement Presentation, if adopted as currently drafted, would also ensure that the presentation was appropriate to the entity and meet the needs of users in this respect.
- c) No comment, as not applicable to our business.

Question 10 - No comment, as not applicable to our business.

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?

We support the Board's proposals to extend the availability of hedge accounting to include net hedge positions and consider this to be in accordance with the stated objective of the project to align hedge accounting more closely with the risk management objectives of the entity. However we do not believe that the proposals go far enough and that the restrictions on the availability of hedge accounting in paragraph 34c reduce the usefulness of this change for entities such as Cobham. Even if the cash flows arise in the same accounting period, the profit or loss impact may arise in different periods. On this point, the ED moves away from meeting its objective to align reporting with risk

management objectives and we would request that this is reconsidered along with portfolio hedging as noted in our covering note.

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 do not agree with this proposal as it does not reflect the desired outcome of the entity in applying hedge accounting. The presentation should reflect the outcome of the risk management activities undertaken by the entity and not a meaningless figure which could be read as an indicator of the success or otherwise of the entity's hedging (and therefore risk management) policy.

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 agree with the proposed disclosure requirements as set out in paragraphs 40-43 but are concerned that the detail in paragraphs 45-52 is excessively onerous, especially for entities such as ours who do not operate in the financial services arena. We feel that these requirements may lead to the disclosures being unacceptably long and create an imbalance in the financial statements of entities whose use of financial instruments is really a by-product of their main business. We also note that whilst the objective of hedge accounting is to present a clear picture of how risks are managed, the disclosures should be focussed more on the impact of the application of the risk management strategies rather than purely on the impacts of hedge accounting. We would therefore request that a review be undertaken of the combined requirements of IFRS 7 and the ED to ensure that excessive clutter is avoided.

Question 14 - No comment, as not applicable to our business.

Question 15 - No comment, as not applicable to our business.

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 in principle with the transition arrangements as outlined in the draft standard, in particular that all IFRS9 requirements should be adopted at the same time. However we are concerned that the proposed implementation date of 1 January 2013 is too soon to allow for the entire standard to be finalised and for entities to properly consider its implementation. As noted in our introduction we would encourage the IASB to complete their deliberations on portfolio hedging and publish those as part of the final IFRS9 prior to application, rather than by way of an amendment to a newly-published standard.