

**TRANSLATION**

Montreal, March 9, 2011

Peter Martin, CA  
Director, Accounting Standards  
Accounting Standards Board  
Canadian Institute of Chartered Accountants  
277 Wellington Street West  
Toronto, Ontario M5V 3H2

Dear Sir:

Please find enclosed the comments of the Exposure Draft Review Committee of the Ordre des comptables agréés du Québec on the Exposure Draft entitled "Hedge Accounting."

Please note that neither the Ordre des comptables agréés du Québec nor any of the persons involved in preparing the comments shall have any liability in relation to their use and no guarantee whatsoever shall be provided regarding these comments, as specified in the following disclaimer.

We would appreciate receiving a copy of the English translation of our comments.

Yours truly,

Annie Smargiassi, CA  
Secretary to the Exposure Draft Review Committee

Encl. Disclaimer and comments

## **DISCLAIMER**

Subject to the conditions described herein, the documents prepared by the Exposure Draft Review Committee of the Ordre des comptables agréés du Québec (the Ordre), hereinafter referred to as the "comments," provide the opinion of members on statements of principles, documents for comment, associates' drafts and final exposure drafts published by the Accounting Standards Board, Auditing and Assurance Standards Board, Public Sector Accounting Board, Risk Management and Governance Board, and by other organizations.

The comments submitted by the Committee should not be relied upon as a substitute for engagements entrusted to professionals with specialized knowledge in their field. It is important to note that the legislation, standards and rules on which the comments are based may change at any time and that, in some cases, the comments may be controversial.

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# **COMMENTS OF THE EXPOSURE DRAFT REVIEW COMMITTEE OF THE ORDRE DES COMPTABLES AGRÉÉS DU QUÉBEC ON THE EXPOSURE DRAFT ENTITLED "HEDGE ACCOUNTING"**

## **TERMS OF REFERENCE OF THE COMMITTEE**

The terms of reference of the Exposure Draft Review Committee of the Ordre des comptables agréés du Québec are to collect and channel the views of practitioners in public practice and members in business, industry, government and education, as well as those of other persons working in related areas of expertise.

For each exposure draft or other document reviewed, the Committee members share the results of their analysis. The comments below reflect the views expressed, and unless otherwise specified, all of the Committee members agree on these comments.

The Ordre has not acted upon and is not responsible for the comments expressed by the Committee.

## **FOREWORD**

The Committee members would like to receive a copy of the English translation of the comments.

## **GENERAL COMMENTS**

Members welcome the Exposure Draft on hedge accounting because, among other things, it simplifies the requirements. Members note that the changes are positive and also adequately reflect an entity's risk management activities.

However, members mention that they would have liked to comment on this Exposure Draft at the same time as the anticipated IASB Exposure Draft on macro-hedging. They point out that certain comments may be changed depending on the proposals included in the IASB's Exposure Draft.

In addition, members point out that managing credit risk, an important component of risk management in certain industries, is not included in the proposed standard on hedge accounting, which is counter to the basic objective of reflecting an entity's risk management activities.

Lastly, members mention that the addition of some examples in various parts of the proposed standard would provide a better understanding of the requirements.

## **SPECIFIC COMMENTS**

### **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?*

Yes, members agree with proposed standards that reflect an entity's risk management activities.

### **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, members 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, because this provides added flexibility.

### **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?*

Yes, members agree with the proposals. However, in their opinion, the accounting aspects are unclear and should be explained through real examples and clear guidance because clarification is required as to whether the entire structure should be considered as including two hedging relationships or whether the aggregate exposure should be accounted for at unamortized cost as a debt in local currency. Such guidance would ensure more consistent treatment.

Members have prepared the following example to illustrate what they find unclear in the proposal:

A financial institution borrows at a fixed rate in a foreign currency (e.g. in USD). It enters into a currency swap under which it receives a fixed amount in USD and pays a fixed amount in a local currency (e.g. CAD). The combined effect of the two instruments (the debt and the swap) creates a synthetic debt in CAD.

The financial institution may want to hedge its interest rate risk with an interest rate swap so that it will pay a variable interest rate in CAD and receive a fixed amount in CAD.

The Exposure Draft seems to allow designation of the interest rate swap along with the aggregate exposure made up of the foreign currency debt and the currency swap.

However, it is unclear whether the aggregate exposure should be carried at amortized cost as a debt in local currency or whether the entire structure should be considered as including two hedging relationships: a currency hedge (hedged item: fixed-rate debt in USD; hedging item: currency swap) and a second hedge, i.e. an interest rate hedge (hedged item: aggregate exposure; hedging item: interest rate swap). In this last case, it is unclear whether the hedged item should be the debt in local currency for purposes of calculating the ineffectiveness of the second hedging relationship.

### **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?

Yes, members agree with the proposals because, in their opinion, the new proposals better reflect an entity's risk management activities.

#### **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?*

Yes, members agree with the proposals as long as they are actually intended to reflect an entity's risk management activities.

(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?*

No, members do not agree with the proposals. In their opinion, reflecting an entity's prepayment risk management should be permitted when a contract provides for the possibility of prepayment by the debtor. Members are aware that it is difficult in practice to isolate a prepayment option relating to a layer component of a contract. However, they believe that this latitude should be allowed, provided the entity can find a practicable way of calculating hedge ineffectiveness.

#### **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?*

Yes, members agree. By eliminating the 80–125 per cent 'bright line', the proposals allow for more flexibility and more closely align the definition of hedge effectiveness with actual risk management as performed in corporations. When designating a hedging relationship and on an ongoing basis, an entity shall analyse the sources of hedge ineffectiveness that are expected to affect the hedging relationship during its term. This analysis (including any updates in accordance with paragraph B60 arising from rebalancing a hedging relationship) is the basis for the entity's expectations of hedge ineffectiveness for the hedging relationship (Application Guidance paragraph B28).

#### **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?*

Yes, members agree with the proposals. However, in their opinion, rebalancing should not be a requirement when the hedging relationship no longer meets the risk management objective and strategy.

(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?*

Yes, members agree with the proposals, as long as the choice is left up to the entities and it reflects their risk management activities. Members point out that the proposals should only focus on the accounting aspects of risk management and not provide standards that affect risk management itself.

### 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?*

The objective of hedge accounting is to show the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. This aims to convey the context of hedging instruments in order to allow insight into their purpose and effect. The discontinuance of hedge accounting should only be permitted when the hedging relationship no longer meets the qualifying criteria or is no longer in keeping with the risk management objective. This avoids the risk of manipulation related to the current model which allows for voluntary discontinuance even if the hedging relationship still meets the risk management objective and strategy and continues to meet the qualifying criteria.

Some members point out that in practice, these proposals may lead to some documentation issues.

### 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?*

Yes, members agree with the proposals because they allow for consistent presentation of the effects of risk management activities, regardless of the type of hedged item.

(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?*

No, members do not agree with the presentation of a separate line item in the statement of financial position. In their opinion, this item would not qualify for recognition as an asset under IAS 1. Members feel that rather than presenting a separate line item, the item should be presented with the hedged instrument, even it implies additional note disclosure. In the members' opinion, the goal of transparency, which is significant, should not outweigh the rules already in place with respect to accounting for an asset or a liability.

(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?*

Yes, members agree with the proposals. They do not believe that a linked presentation would be in keeping with the goal of transparency.

### 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 (eg 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?

(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?

Yes, members agree with the proposed two-step approach. However, they find it difficult to differentiate the time value of options related to a transaction and time value related to a period of time. The concept seems a little blurred and they believe that examples should be provided in the Application Guidance.

(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 (ie 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?

Yes, members agree with this principle. In their view, if the critical terms do not match, the gains or losses should be recognized in profit or loss.

#### **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?*

Yes, members agree with the proposal because it is consistent with the treatment of hedges of individual items. Permission to use hedge accounting for a net position represents a significant improvement from IAS 39 requirements since it will provide a more faithful image of an entity's actual risk management.

#### **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?*

Yes, members agree. However, they believe that additional disclosures should be presented in the notes to the financial statements.

#### **Question 13**

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

Yes, members agree with the proposed disclosure requirements because, in their opinion, they will improve users' understanding of the effects of hedge accounting. In addition, the goal of transparency will be maintained.

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

Members would like additional disclosures on net positions (see question 12).

#### **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?*

Yes, members agree with the proposals. In their opinion, they will reflect the objectives of the contracts and the entity's risk management strategy.

#### **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?*

No, members do not agree that the proposed treatments will add unnecessary complexity to accounting for financial instruments. In their opinion, an entity should not be prevented from using hedge accounting if it can demonstrate that hedge accounting is applicable to the entity's credit risk management. In the members view, credit risk is no different from other types of risk. Consequently, accounting should be allowed in order to reflect credit risk management activities.

*(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?*

Members indicate that the third alternative will cause the least volatility and that it is consistent with the current method of accounting for hedging relationships.

#### **Question 16**

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

Members agree with the prospective application of the proposals. However, given that several other standards will have to be applied on the proposed date and that members expect several changes to existing procedures will be necessary, they suggest instead January 1, 2015, with the possibility of early adoption for those entities that wish to do so. Members also mention that the proposals relating to macro-hedges are forthcoming and should be available for application on the same date.