



February 8, 2011

Via website posting: <http://www.iasb.org/>

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

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft: **Hedge Accounting(ED/2010/13)**. In addition to responses to the specific questions, we have also provided additional comments on certain related matters.

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?

Comments

CGA-Canada agrees with the proposed objectives of hedge accounting and believes that the objective properly sets the context and purpose of the proposed new standard on hedge accounting. The proposed objective strikes a fine balance by not being either, too narrow to focus exclusively on the mechanics of hedge accounting, or too broad to capture the essence of the entity's risk management activities and the presentation of outcomes of such activities in the financial statements. We believe that the proposed objective establishes an overall principle for hedge accounting that is missing in the current IAS 39 requirements. However, we suggest that the objective should be further refined and focused on financial risks, as risk management might address a variety of risks that could not be captured in the financial statements.

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?

Comments

CGA-Canada agrees with the proposals for allowing a non-derivative financial asset and a non-derivative financial liability, measured at fair value through profit or loss, to be eligible hedging instruments, and with the board's rationale articulated in the paragraphs BC 28-40. We also endorse the proposal for disallowing internal derivatives as hedging instruments. However, we believe that disallowing intra-group monetary items as qualifying hedging instruments is inconsistent with their eligibility as hedged items. The board's reason for this position, as stated in BC 47 (not having a project on agenda for reviewing IAS 21), is neither conceptually sound nor conducive to the development of high quality, principles-based standards. We also do not see any conceptual basis for not allowing, as hedging instruments, any non-derivative financial instruments not measured at fair value through profit or loss.

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?

Comments

CGA-Canada supports the proposal that an aggregated exposure that is a combination of another exposure and a derivative (a synthetic exposure) may be designated as a hedged item. We believe that the proposal will eliminate the existing anomaly and inconsistency in the current IAS 39 which permits derivatives as hedging instruments, but not as hedged items except as provided in paragraph AG 94. The underlying assumption is that derivatives are held for trading, if they are not hedging instruments. This assumption is not aligned to the actual risk management activities of the entities, and we believe that the proposal will better reflect the risk management activities in the financial statements in accordance with the objective of the proposals. However, we suggest providing more implementation guidance on the accounting for derivative in an aggregate exposure that is in a hedging relationship, as it is not clear if such derivative should follow amortised cost model or fair value through profit or loss model.

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?

Comments

CGA-Canada agrees with the said proposal. We believe that the proposal will eliminate yet another anomaly and inconsistency in the current IAS 39 which makes an arbitrary distinction between monetary and non-monetary items for the purpose of eligibility as a hedged item designation. The proposed qualifying criteria are more objective and conceptually on a sounder footing. The proposal will allow the users of commodity derivatives flexibility to apply hedge accounting for better reflecting their risk management activities. However, we are unsure as to why non-contractually specified risk component (for example, inflation) cannot be designated as an eligible hedged item.

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?

Comments

(a) CGA-Canada agrees that that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item. However, we note that the accounting outcome will be different when a percentage component of a nominal amount is designated as a hedged item.

(b) CGA-Canada agrees 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. We concur with the Board's rationale articulated in BC 69 that, if the prepayment option's fair value changed in response to hedged risk, a layer approach would be tantamount to identifying a risk component that was not separately identifiable (because the change in the value of

the prepayment option owing to the hedged risk would not be part of how hedge effectiveness would be measured).

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?

Comments

CGA-Canada supports the hedge effectiveness requirements as a qualifying criterion for hedge accounting. Although the proposal will necessitate changes in systems and procedures for most entities, we particularly welcome the proposal to eliminate the requirement to assess the effectiveness retrospectively. We also suggest that the implementation guidance should clarify that a hedging instrument need not be the one that provides the best offset of risk, but should be one that is best aligned to the risk management policies of the entity. We further suggest that the proposals should define the term *critical terms* of a hedging instrument and hedged item, as well as explain the meaning of their *close alignment*. Also, we suggest clarifying that, in order to apply hedge accounting, a hedging relationship must be aligned with an entity's risk management objectives at inception.

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?

Comments

(a) CGA-Canada supports the proposal regarding rebalancing and the objective-based hedge effectiveness assessment. We believe that the current IAS 39 approach of discontinuing hedging relationship on rebalancing is inflexible and does not account for the fact that rebalancing would be a norm rather than an exception in the highly volatile and dynamic markets of present day. However, we believe that more guidance is required to enable entities to decide what would constitute unbiased result, minimum hedge ineffectiveness, and when rebalancing would be appropriate.

(b) CGA-Canada agrees with the proposal 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. We believe that such an approach is an important component of active risk management policy, and it is superior to passive and reactive rebalancing *ex post facto*.

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?

Comments

- (a) CGA-Canada agrees with the proposals for discontinuation of hedge accounting for a hedging relationship. We believe that, relative to the current requirements in IAS 39, the proposals are more objective and dynamic because of the inclusion of the principles of new hedge effectiveness assessment and rebalancing. We believe that the proposals will more closely align hedge accounting with the risk management policies of entities.
- (b) CGA-Canada agrees 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. We believe that the current provision in IAS 39 for voluntary discontinuation of hedge accounting provides an opportunity for structuring. Also, it is not conceptually sound, is arbitrary, and does not necessarily result in useful information.

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?*

Comments

- (a) CGA-Canada agrees with the proposals for fair value hedge accounting, requiring that 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. We believe that the proposals will avoid mixed measurement for the hedged item, reduce volatility in OCI and, at the same time, provide useful information.
- (b) CGA-Canada agrees 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 because this separate line item will preserve the amortised cost basis of the hedged item.
- (c) CGA-Canada agrees that linked presentation should not be allowed for fair value hedges because it is consistent with the policy of not accommodating requirement of a specific industry in the general purpose accounting standards. Also, we agree with the Board's rationale articulated in BC128 that the linked presentation does not differentiate between the types of risk hedged and the resulting totals of assets and liabilities may not be appropriate for ratio analysis. It would be better to provide required information through appropriate disclosures.

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?

(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?

Comments

(a) CGA-Canada agrees 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 because, as reasoned in BC 148, it is appropriate to consider the option's time value as an "insurance cost", and it would be consistent to account for balances accumulated in other comprehensive income in accordance with the general requirements. We expect that, as a result of the proposals, the entities will be required to analyze and document their hedging strategies in order to make such determination.

(b) CGA- Canada also agrees with the proposal related to the part of the aligned time value for period related hedged item, for the reasons stated above.

(c) CGA-Canada does not support the proposal that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item, because we believe that it may not be practical for the entities to always identify the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item. As a result of the proposal, the entities may be required to make highly subjective judgements regarding critical terms and appropriateness of a particular option. We suggest simplifying accounting by making an implicit assumption that the actual time value of the option is the 'aligned time value' of the option. This is a reasonable assumption, as an entity is expected to purchase the best available option in accordance with its risk management policy.

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?

Comments

CGA-Canada is in general agreement with the broad criteria for the eligibility of groups of items as a hedged item. We believe that these criteria are internally consistent and more aligned to risk management practices of an entity, relative to current provisions of IAS 39 which are more stringent and based on rules rather than principles. We also welcome the proposal to permit the net position of hedging of a group of items, and consider it another improvement over the current requirements of IAS 39. At the same time, we also concur with the Board's rationale articulated in BC 168-173 for not allowing cash flow hedge of a net position, if the offsetting cash flows would affect profit or loss in different reporting periods. We expect that the underlying principles will also be replicated as, and when, the Board develops standard on macro hedging.

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?

Comments

CGA-Canada agrees with the proposal that, for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement, 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. We believe that the proposal has a sound conceptual basis and that the rationale articulated in BC 175 is correct. However, as far as presentation of a fair value hedge of a net position is concerned, we are of the opinion that the proposal for presenting in the statement of financial position separate line items of the gross amounts of the gains/losses relating to each asset/liability is internally inconsistent, as it would give rise to the similar “grossed up” amounts in the statement of financial position that the Board tried to avoid in the income statement. We believe that the better alternative would be to provide the relevant information through appropriate disclosures.

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?

Comments

(a) CGA-Canada notes that the proposed disclosure requirements are a result of dissatisfaction of users with the current requirements in IAS 39. We are unsure if the proposed disclosures will meet the requirements of the users, and suggest further field testing and outreach activities. We also suggest that the proposed disclosures should be evaluated for consistency and harmony with the required disclosures in IFRS 7 *Financial Instruments: Disclosures*. It is highly desirable that the disclosure requirements in IFRSs are not developed on an ad-hoc basis, but that they are based on uniform principles.

(b) We do not agree with the Board’s decision of not requiring disclosures pertaining to transactions not qualified for hedge accounting although the purpose of the transactions is to manage a specific risk exposure. We believe that such disclosures are necessary for completeness, transparency and providing to users decision-useful information. Subject to this remark, and other comments made in this letter, we have not identified other disclosures that would provide useful information.

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?

Comments

CGA-Canada concurs 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. We believe that the proposal will improve efficiency and lessen the unnecessary burden on entities. However, in view of the urgency of the change, we suggest exploring the possibility of effecting this change through Annual Improvement process, instead of by amending IAS 32.

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?

(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?

Comments

(a) CGA-Canada concurs that separate and reliable measurement of credit risk component of a loan or loan commitment is operationally difficult, and accounting of credit risk default swap at fair value through profit or loss increases the volatility. However, we do not agree with any of the three proposed accounting alternatives, as they entail making exceptions to a principle-based standard on hedge accounting and, at the same time, add unnecessary complexity to accounting for financial instruments. These accounting alternatives also create an exclusive hedge accounting model for a specific industry in defiance of the IASB's stated position to the contrary.

(b) As stated above, we would accept volatility in profit or loss rather than develop an industry specific standard for hedge accounting. We further suggest addressing the issue of separate and reliable measurement of credit risk component of a loan or loan commitment under the IASB project *Fair Value Measurement*.

Question 16

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

Comments

CGA-Canada agrees with the proposed prospective application of the new hedge accounting standard and simultaneous adoption of IFRS 9. We believe that the proposed transition requirement is conceptually sound, internally consistent, and pragmatic. We also note that the Board has recently published the request for views *Effective Dates and Transition Methods*, and that the Board will take into consideration the comments received on that document and on the transition proposals in the exposure draft when finalising the transition requirements for hedge accounting.

Additional Comments

We believe that, overall, the proposed hedge accounting model exemplifies one of the most pragmatic and conceptually elegant improvements undertaken by the Board in the process of replacing IAS 39. We particularly welcome the proposals to align hedge accounting with risk management, permitting the designation of non-derivative financial assets/liabilities that are measured at fair value through profit or loss as hedging instruments, allowing risk components of non-financial assets/liabilities as hedged items

subject to specific criteria, permitting rebalancing of hedging relationship, and eliminating arbitrary tests of hedge effectiveness.

However, we are concerned that in these, as well as several other recent proposals, OCI is increasingly employed as a default residual account for parking balances which otherwise cannot be properly accounted either in income or equity. We believe that this trend pre-empts any future exercise to develop a principles-based concept of OCI. We further note that replacement of IAS 39 is undertaken by means of independent and separate projects. We believe that a holistic review of the replacement standard would be necessary for internal consistency and integration. We are also concerned about the divergent views held by IASB and FASB on accounting for Financial Instruments and their unsynchronised work plans. Stakeholders favour an early resolution of these issues in the interest of meaningful convergence of globally accepted accounting standards. It is also hoped that the Board will further develop a standard for macro hedging, and finalize the standard on general hedging only thereafter.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamallesh Gosalia at kgosalia@cga-canada.org or, alternatively, the undersigned at rlfebvre@cga-canada.org.

Sincerely,

[Original signed by:]

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Vice-President, Research & Standards