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FEDERATION OF ACCOUNTING PROFESSIONS UNDER THE  
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FAP 557/2554

March 8, 2011

Sir David Tweedie Chairman  
The International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH  
United Kingdom

RE : Comments on the ED/2010/13 : Hedge Accounting

Dear Sir David :

The Federation of Accounting Professions, Thailand, appreciate the opportunity to comment on the IASB's ED/2010/13 on Hedge Accounting. Our comments have been prepared and reviewed together with representatives from Bank of Thailand, representatives from commercial banks and stakeholders.

Our detailed comments to specific matters identified in the ED are set out in the Appendix to this letter.

We hope that our comments will contribute to the work of IASB. Should you have any questions, please do not hesitate to contact us.

Yours sincerely,

Professor Emeritus Kesree Narongdej  
President  
The Federation of Accounting Professions  
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# Appendix

## Comments on the Exposure draft (ED/2010/13): Hedge accounting By the IFR8 Club & the Federation of Accounting Professions, Thailand

### 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 agree with the objective of ED-hedge accounting, which is to reflect risk management activities that offset the risk bearing in the underlying transaction in the financial statements, resulting in reduction of profit and loss volatility.

### Comment

- @ To be consistent with risk management objective and activities, the risks inherent in the equity securities classified as FVTOCI, which could be both price and FX risk, should also be reduced. Hence, the classification of financial assets should not be a prohibiting factor to hedge accounting.
- ® Furthermore, IAS 39 allows equity securities that are measured at cost to be a hedged item for currency risk. Despite the application of historical rate for translating non-monetary assets, IAS 39 IG E3.4 provides an exception in allowing such equity security investment as a hedged item for fair value hedge. Consequently, this hedged item is re-measured for changes in foreign currency rates
- ® Hence, reduction of risks that are separately identifiable and reliably measurable should be the determining factor of hedge accounting, and resulting in reducing not only profit and loss but also OCI.

### 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?

- ® We 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

### Comment

- ® However, we have one concern in that the ED requires asset/liabilities to be designated as hedging instrument only in its entirety, while, in reality, management may hedge a particular risk associated with the hedged item. Derivatives such as options and forward contract are allowed to apply specific component inherent in the derivatives to hedge the designated risks. The same principle of component designation should be applicable to non-derivative assets/liabilities. For example, an entity should be allowed to designate only a risk component such as Libor when a



fixed rate USD treasury bill classified as FVPL is used as hedging instrument to hedge the changes in fair value of a fixed rate USD bond issued. In short, FVPL non-derivative items should not be limited to be assigned as hedging instrument in its entirety.

### 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 generally agree on the concept that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item.

### Comment

- ® We understand that based on the ED Para B9 (b) example, CCS is considered part of the aggregated exposure. We simply modify the tenor of the fixed rate \$ issued debt in the example from 10 years to 5 years. We have a 10-year CCS which is included in an aggregate exposure only for the first 5 years. According to our understanding, CCS plays the role of a derivative initially in the aggregate exposure. Hence, it is marked to market.
- However, if we apply the IRS as the hedging instrument for the aggregate exposure, CCS is now part of the hedged item which can be for partial term and risk component based. Consequently, CCS being a hedged item is eligible for the partial term of 5 years and is accounted for at the same basis as the Euro issued debt at amortized cost. For the remaining 5 years, CCS will be used as a hedging instrument for a new issued debt. It will then be marked to market accordingly.
- ® To ensure our understanding on this concept, we need clarification on how to treat the derivative included in the aggregate exposure.

### 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?

- We agree on the proposed ED as the risk component based designation of hedged item, if separately identifiable and reliably measurable, align with risk management practices.

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### 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?

- We agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item.

#### Comment

- We understand that the hedge of a group of assets is for a close portfolio. However, when it addresses the net position hedge, it refers to a group of assets that rolls over. The latter suggests an open portfolio. What is the difference between macro hedge and an open net position portfolio hedge?

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?

- ® We understand that the logical concept of the standard doesn't prohibit if we can identify the stable portion but we would like to have the clarification on the prohibition of layer component. Let illustrate the concept based on our situation.

For example, housing loan has 20-25 year contractual life. But if we consider the historical customer behavior, the statistic shows that:

1. 10% of housing loan portfolio would prepay at the first 2 years
2. 20% of housing loan portfolio would prepay at the year 3 - 5
3. The rest of 70% of housing loan portfolio would stay with bank until the maturity date.

So, in this case, can we apply fair value hedge only for the stable bottom layer of the 70% portion that has no prepayment? On the other hand, could we conclude that the ineligibility pertains to the layer not the option?

#### 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 proposed hedge effectiveness requirements, which aim to align the qualifying criterion of hedge accounting with the risk management.

#### Comment

- However, the Para. B32 of the ED requires hedge effectiveness test at inception and ongoing at each reporting date or upon a significant change. We would like to propose to assess hedge effectiveness upon a significant change. It is deemed to be the most effective means in assessing hedge effectiveness and avoids the ambiguity of the terminology: "*reporting date.*" *The latter has been interpreted as annual or quarterly period.*

#### 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?

- ® We agree with the ED to allow the alternative for „Rebalancing the hedge relationship upon the incurred ineffectiveness or proactively rebalancing when the risk management objective for a hedging relationship remains the same.

#### 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?

- © We agree on both points as they support the objective of hedge accounting to reflect the risk management activities.

#### 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?

#### Comment

- ® We understand that objective of the standard is to align accounting methodology of fair value hedge with that of cash flow hedge. However, we would like to propose the opinions that :

1. Fair value hedge accounting in IAS 39 allows MTM of both hedged and hedging item to be offset in PL is more appropriate and it is self-explanatory in principle. While, the ED requires to post MTM to OCI and then transfer the ineffective portion to PL immediately.

2. In addition, for discontinued fair value hedge, other than the rewinding of the previous hedge accounting adjustment on hedged interest-bearing assets or liabilities, no specific procedure is required under IAS 39. ED, on the other hand, has not addressed how to treat the balance in the OCI upon discontinuation of fair value hedge accounting.

Therefore, it is simpler and clearer to apply the fair value hedge under IAS 39.

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?

Comment

® We do not agree to present the gain or loss *on* the hedged item attributable to the hedged risk as separate line because:

1. In the emerging market, the hedge accounting is not widely used so it will not be that significant to present in separate line. We understand that the financial statement should be prepared under decision-useful based on IAS 1 framework. Requirement to separately disclose these transactions on the face of financial statement seems to contradict with IAS1 of materiality and aggregation concept.

2. In addition, the entity has to disclose detailed information of hedge accounting as required by standard both in qualitative and quantitative in notes to financial statement. This has already provided sufficient information to the users to assess our risk management strategies.

Therefore, we would like to propose to present the gain or loss on the hedged item attributable to the hedged risk in Other Assets or Other Liabilities with the consideration of materiality to separate line presentation, and provide detail in the notes to financial statement instead.

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?

- © We agree that the linked presentation should not be allowed for fair value hedges because the significant information of hedge accounting is already required to disclose in section "Risk management of Note to financial statement."

#### 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 capitalized 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 (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?

- ® We agree that the time value of option for hedging purpose should be considered as cost of hedging and be kept in OCI in order to reduce the profit and loss volatility.

#### Comment

- © We then would like to propose the accounting to recognize the time value of options below:

1. Test effectiveness only for the intrinsic value portion to ensure that these options qualified for hedge accounting. However, the ED requirements to identify time value of option that perfectly matches with that of hedged item and the requirements to recycle that part from OCI to PL is too cumbersome and seems to outweigh cost over benefit. This is because time value normally will be very insignificant except for the long-dated one.

2. If the hedge relationship could meet the effectiveness requirement in 1), the whole amount of time value of option will be recognized in OCI as it represents cost of hedging tool.

3. This cost of hedging will be recycled to PL on the straight line method until maturity. If the hedged items are forecasted transaction, the cost of hedging could not be recycled to PL until that forecasted transactions turns to be assets or liabilities and be realized in PL.



#### 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 agreed with the criteria for the eligibility of groups-of items as a hedged item because this will be support and align with 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 (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 agree that the gains or losses on hedging instrument from a hedge of a group of items should be presented in a separate line from those affected by the hedged items since this will align with the risk management of managing risk on the group of items basis. Besides, it is not practical to separate the portion of each hedged items.

#### 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 agreed with the proposed disclosure requirements as it provides uniform guideline to all the entities for appropriate disclosure.

#### 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?

- © As it is not applicable to Banking industry in Thailand, we have no comment on this point.

### Question 15

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?

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?

- All of these proposed accounting treatments cannot be applied in Thailand due to the limitation of fair value on loan; therefore, it is not applicable to propose any comments.

### 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 with the proposed transition requirements to be applied prospectively.  
Comments on the Exposure draft (ED/2010/13) y Hedge accounting By  
the Bank of Thailand & the Federation of Accounting Professions, Thailand

The Bank of Thailand (BOT) has preliminarily considered main concepts and practical issues raised from this Exposure Draft which may have significant impact on financial institution system of Thailand. In this matter, BOT agree with the proposed hedge accounting objectives and concepts to be more aligned with an entity's risk management. Nevertheless, we would like IASB to further consider our concerns as follows:

1) Additional application guidance and illustrative examples should be provided to enhance greater understandability, practicality and consistency, particularly on qualitative effectiveness test and ways to identify and measure risk components.

2) Quantitative test should be maintained as one of the criteria for Hedge Accounting (in addition to qualitative requirement), particularly in the case where hedging instruments are exotic derivatives.

3) Accounting for time value of option, as cost (recognized in OCI) or hedge ineffectiveness part (recognized in P&L), should be an alternative for the entity to apply one that is in accordance with an entity's risk management. Also, supplement disclosure on this choice should be enforced to enhance users' understandability on nature of transactions and effects.

4) Change in hedge effectiveness test should be limited to only when there is a change in entity's risk management or a major change in economic circumstance to ensure consistency in effectiveness test. Examples or clarification on circumstances should be provided.