

8 March 2011

**International Accounting Standards Board (IASB) Exposure Draft ED/2010/13 *Hedge Accounting Question 10***

Dear Sir/Madam

Thank you for the opportunity to comment on the IASB Exposure Draft ED/2010/13 *Hedge Accounting*. This letter expresses the views of Eskom Holdings Limited (Eskom). Our letter responds only to the proposal in question 10 of the ED, regarding the accounting for the time value of purchased options.

An entity can in terms of paragraph 33, separate the intrinsic value and time value of an purchased option contract and designate only the change in intrinsic value of the option as the hedging instrument.

If an entity designates only the change in the intrinsic value of a purchased option as the hedging instrument in a cash flow hedge, then the change in the fair value of the time value of the option would be recognised in other comprehensive income to the extent that it relates to the hedged item. If the time value of the option is related to a transaction related hedge which results in the recognition of a non-financial asset, the entity shall remove the amount from other comprehensive income and include it directly in the initial cost or carrying amount of the asset.

The time value of the option would relate to a transaction-related hedged item if the nature of the hedged item is that of transaction costs. An example of a transaction-related hedged item is an entity hedging the future purchase of a commodity against commodity price risk and the transaction costs are included in the initial measurement of the inventory.

Eskom is currently undertaking a significant capital expansion programme to build power stations, budgeted at a cost of ZAR452 billion (approximately USD 66 billion) over the next 6 years, excluding borrowing costs, with the foreign content being estimated at 30% of the cost. Foreign exchange contracts (FECs) are taken out as part of Eskom's risk management policy to hedge the foreign purchases against foreign currency risk. Only the spot to spot elements of the FEC's are

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accounted for in other comprehensive income for the cash flow hedges while the "interest element" of the FEC's are expensed to the income statement. This is due to the fact that the lead time of acquiring the items to build a power station are up to five to seven years and the fact that FEC's can only be taken out for a year at a time in terms of the country's Reserve Bank regulations. This results in it being very difficult to prove hedge effectiveness for the time (interest) element of the FEC's.

The above results in a large expense in the income statement for the interest element of the FEC's which in reality relates to the construction of new power plants. Non-accountants (and even accountants) find it very difficult to understand why the income statement should be impacted by the interest element of FEC's when the foreign currency risk of the power stations is hedged.

Eskom would like the IASB to consider whether the change in the fair value of the time value in FEC's could be treated in a similar way as the time element of purchased options and be allowed to make a basis adjustment to the non-financial asset (property, plant and equipment) via other comprehensive income. If that is found to be correct, then it is suggested that the exposure draft be amended to make provision for a foreign exchange contract with an illustrative example.

Eskom would welcome a proposal to capitalise the change in the fair value of the time value of FECs in order to achieve consistency with the proposal to capitalise the change in fair value of purchased option's time value and align accounting treatment to reflect management's risk management policy.

Please contact Paul O'Flaherty at +27 11 800 2101 or Jacob Buys at +27 11 800 4703 if you wish to discuss the issues regarding our comment letter.

Yours Sincerely,

A handwritten signature in black ink, appearing to read 'P. O'Flaherty', with a stylized flourish at the end.

**Paul O'Flaherty**  
**Finance Director: Eskom Holdings Limited**