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Date
March 9, 2011

Re: IASB Exposure Draft ED/2010/13  
Hedge Accounting

## Comment Letter of The Linde Group

Dear Sir David,

The Linde Group is a world leading gases and engineering company with almost 48,000 employees working in more than 100 countries worldwide. In the 2009 financial year it achieved sales of EUR 11.2 billion. We offer a wide range of compressed and liquefied gases as well as chemicals and we are therefore an important and reliable partner for a huge variety of industries. Our engineering division is successful throughout the world, with its focus on promising market segments such as olefin plants, natural gas plants and air separation plants, as well as hydrogen and synthesis gas plants.

The Linde Group is listed in the leading German share index (DAX) and prepares its consolidated financial statements in accordance with International Financial Reporting Standards as adopted by the European Union. We therefore appreciate the opportunity to comment on the Exposure Draft ED/2010/13 *Hedge Accounting* from an industrial company perspective.

We strongly support the initiatives of the Board aimed at increasing the usefulness of information for external and internal decision-makers. In this context, publishing the ED/2010/13 with the intention of aligning hedge accounting more closely with risk management is an important step in the IASB project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

The Linde Group supports the general direction of the ED as it provides a number of considerable improvements to the current IAS 39. First of all, the ED removes a number of significant and economically unjustified restrictions to hedge accounting and improves the measurement of hedge effectiveness aligning it with the

underlying risk management strategy. Furthermore, by widening the range of possible hedged items such as derivatives, risk components and net positions or by permitting hedge accounting on components of non-financial items, hedge accounting becomes more flexible to adequately reflect complex and variable risk management strategies.

Despite our general support, we have some concerns with the proposals in the ED. These are in detail set out in the appendix to this letter. To summarise, we believe that the ED imposes unnecessary restrictions such as the rebalancing obligation or the restriction to discontinue hedge accounting voluntarily.

Instead of imposing entities to rebalance we would recommend to leave the rebalancing decision to preparers in accordance with their risk management strategies. The same applies to the discontinuing of hedge accounting. Regarding the variety and flexibility of risk management strategies we would propose to retain the possibility of discontinuing hedge accounting voluntarily instead of restricting this possibility. This would also be in line with the voluntary character of designating hedge accounting relationships.

We would furthermore suggest including the fair value hedge adjustments in the same line item as the hedged item on the face of the statement of financial position rather than presenting them in separate line item. The problem of mixed measurement can then be solved by disclosing disaggregated information in the notes to the financial statements.

If you have any questions or remarks, please do not hesitate to contact us. We would be happy to discuss any of our comments with you at your convenience.

Yours sincerely,

Björn Schneider  
Head of Group Accounting & Reporting

Crispin Teufel  
Head of IFRS Competence Center & External Reporting

**Appendix: Answers to the questions raised in the ED**

**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 support the Board's intention to introduce a general objective as a basis for a principle-based approach to hedge accounting providing assistance for the understanding and interpretation of the proposed requirements. The objective of hedge accounting proposed in the ED is ' [...] to represent in the financial statements 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 approach aims to convey the context of hedging instruments in order to allow insight into their purpose and effect' (ED/2010/13, par. 1). This objective helps to align the presentation of an entity's hedging activities in the financial statements more closely with its risk management strategy.

We therefore also support the proposal to retain the voluntary designation of hedge accounting relationships as it would not be possible to apply hedge accounting to the large variety of risk management strategies that exist in practice.

Additionally, we would propose to allow the designation of a hedging instrument for only a portion of its remaining period, provided this is in line with the entity's risk management strategy and the hedging instrument's fair value can be reliably disaggregated into its components.

**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 with the proposal that non-derivative financial assets or non-derivative financial liabilities measured at fair value through profit or loss should be eligible hedging instruments as this will enable entities to align accounting and risk management.

**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 that a synthetic exposure (i.e. a combination of a non-derivative instrument and a derivative) may be designated as a hedged item. We believe that this proposal will eliminate a significant restriction that cannot be economically justified and should facilitate hedge accounting for entities entering into transactions that give rise to a combination of different risks.

**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 that an entity should be allowed to designate a risk component as a hedged item if it is separately identifiable and reliably measurable. As already mentioned, this would enable entities to align accounting and risk management.

**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?

We strongly support the Board's proposal to allow designating a layer component of the nominal amount of an item as hedged item. This approach is a useful answer to conditions of uncertainty and will enable entities managing layer components in their risk management to adequately account for these hedges.

**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 80 to 125 percent test for assessing and measuring hedge effectiveness and the introduction of an objectives-based assessment. This will help to align accounting closer to risk management.

**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 that an entity should be allowed to rebalance hedging relationships because this enables the entity to reflect changes that occur in a hedging relationship from a risk management perspective. This reflects the fact that risk management can be a dynamic activity and may require flexibility. Under the current IAS 39, an entity is required to discontinue hedge accounting and restart the hedging relationships again for accounting purposes even if risk management objectives remained the same. The proposed rebalancing approach avoids these inconsistencies and will therefore lead to further alignment of accounting and risk management.

However, we do not agree that an entity should be required to rebalance its hedging relationships. We believe that the ED is not clear on when rebalancing is required, when it is acceptable not to do so and when the criteria regarding the proposed requirements are met. It also remains unclear which are the consequences when an entity does not rebalance. For example, a requirement to rebalance a hedge of expected future cash flows at every time the expectations regarding the timing of the future cash flows change slightly may create a frequent need for rebalancing with excessive trading costs associated. Thus, we recommend the Board to leave the rebalancing decision to preparers in accordance with their risk management strategies.

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 generally agree that an entity should discontinue hedge accounting prospectively when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria. Regarding the prohibition of voluntary de-designation, we acknowledge the Board's opinion that if an entity's risk management strategy did not change the accounting treatment should not be changed either.

However, we would seek further clarification regarding the definition of a change in an entity's risk management strategy. The standard proposal should not force treasury departments to change their economic hedging strategies in order to comply with hedge accounting requirements. Regarding the variety and flexibility of risk management strategies we would propose to retain the possibility to discontinue hedge accounting voluntarily. This would also be in line with the voluntary character of designating hedge accounting relationships.

As discontinuing a hedge accounting relationship itself does not lead to an immediate reclassification of amounts stored in OCI to profit or loss (in the case of cash flow hedges), voluntary discontinuation would also not be a driver to generate income effects and should thus be permitted.

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?

We do not believe that the two-step approach of recognising gains or losses on the hedging instrument and the hedged item in other comprehensive income in a first step and immediately transferring the ineffective portion of the gain or loss to profit or loss in a second step provides additional information value. In addition, we cannot

identify the underlying rationale that supports the recognition of gains or losses of the hedging instrument and hedged item in other comprehensive income in the first step.

Furthermore, we do not support the separate presentation of gains or losses on the hedged item attributable to the hedged risk as a separate line item in the statement of financial position. This will not only overload the statement of financial position and confuse users of financial statements; the fair value changes of hedged items are no individual assets or liabilities but belong inseparably to the underlying hedged item and should therefore be presented as a unity. The problem of mixed measurement (e.g. an amount that is amortised cost with a partial fair value adjustment) can be solved by disclosing disaggregated information in the notes to the financial statements.

We agree that linked presentation should not be allowed for fair value hedges because this is consistent with the policy of not accommodating requirements of a specific industry in the general purpose accounting standards. We also agree with the Board's rationale articulated in BC128 that the linked presentation does not differentiate between the types of risk hedged and that the resulting totals of assets and liabilities may therefore not be appropriate for the purpose of ratio analysis.

**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 general requirements (e.g. 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 (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 with the proposal that the reclassification of changes in an option's time value accumulated in other comprehensive income should be in accordance with general requirements for transaction related hedged items. We also 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. The proposal eliminates the recognition of accounting-driven inefficiencies due to the time value component in options that do not exist from a risk management perspective. This will enable entities to align accounting and risk management more closely.

**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 generally support the Board's proposal to allow net positions as hedged items in accordance with an entity's risk management strategy as this proposal removes an unnecessary obstacle of the current IAS 39.

The Board decided not to address open portfolios or macro hedging as part of this ED but rather continue to discuss proposals for hedge accounting for open portfolios. As any decision on groups of items will impact these ongoing discussions, it is difficult to comment or conclude on groups of items as hedged items without knowing the proposals for open portfolios or macro hedging. We would therefore recommend the Board to finalise its discussion on portfolio hedge accounting as soon as possible.

**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 with the proposals regarding the presentation in profit or loss of the effects of hedge accounting for groups of items. Separate presentation of gains or losses from hedging instruments designated to hedge a group of hedged items with offsetting hedged risk positions affecting different line items, avoids the problem of grossing up those gains or losses and thereby distorting the income statement with amounts that do not exist.

Regarding the presentation of gains or losses from fair value hedges of net positions we refer to our response to Question 9.

**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 that disclosures can be substantial to understand the risk management strategy and the hedging activities of an entity. We also acknowledge that the Board emphasises the judgement in the determination of the extent of disclosures in the individual areas compared to IAS 39. To follow this objective we would recommend to include par. 44-52 in the application guidance. Including par. 44-52 in the standard itself may be interpreted as a mandatory list that needs to be fulfilled irrespectively of the conditions and circumstances of



the entity. In addition, we believe that the disclosures required, especially in par. 45-48, may include sensitive information that should not be available to the public. We therefore recommend to develop disclosure requirements on a more general level in such sensitive areas.

In general, we would also need more guidance on how the proposed disclosures interact with the required disclosures in IFRS7 *Financial Instruments: Disclosures*. The current disclosure developments in recent EDs in the area of financial instruments increase the cost and efforts for preparers even further, with users of financial statements being faced with vast amounts of details. We believe that there should be a review of the existing and proposed disclosure requirements for corporate entities in their entirety rather than on a standard by standard basis in the light of decision usefulness and associated costs.

**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?**

We generally support the Board's intention to facilitate the sometimes burdensome hedge accounting requirements regarding commodity contracts by proposing that derivative accounting would apply to contracts that would otherwise meet the 'own use' scope exception. However, we have concerns that the current concept is not sufficient to enable accounting to adequately reflect the complexity of commodity risk management strategies of industrial companies. We therefore urge the IASB to further investigate the issues with affected companies before finalising the proposals.

**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?**

We do not agree with any of the three proposed accounting alternatives as they all entail exceptions to a principle-based standard and, at the same time, increase complexity to accounting for financial instruments. We believe that prohibiting hedge accounting for credit risks is not consistent with the objectives followed by the Board as it would create a difference between accounting and risk management that cannot be economically justified. Therefore, we would propose that hedge accounting should be allowed for credit risks if all other criteria for hedge accounting are met.

**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 effectiveness of IFRS 9 for annual periods beginning on or after 1 January 2013 with earlier application permitted. It should be noted, however, that as a prerequisite of this proposed timeline, the Board needs to finish its discussions regarding e.g. open portfolio and macro hedging or amortised cost and impairment as soon as possible to allow enough lead time for the implementation of the new requirements.

We also support the Board's intention to apply the requirements prospectively as hedge accounting relationships can only be designated prospectively.