



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

9 March 2011

Dear Sir David,

RE: IASB EXPOSURE DRAFT ED/2010/13 HEDGE ACCOUNTING

Thank you for the opportunity to comment on the IASB exposure draft ED/2010/13 Hedge Accounting ('ED').

Wesfarmers Limited (Wesfarmers or the company) is one of Australia's largest listed companies, retailers and employers. Wesfarmers' portfolio of businesses includes:

- retail operations covering supermarkets, general merchandise and speciality department stores, fuel and liquor outlets and home improvement and office supplies;
- coal mining;
- gas processing and distribution;
- electricity generation;
- insurance;
- chemicals and fertilisers; and
- industrial and safety product distribution.

Wesfarmers operates from approximately 4,000 locations across Australia and New Zealand and employs over 200,000 people across the Group. Wesfarmers current hedging activities relate to foreign exchange risk management for USD sales and purchases and interest rate risk management through interest rate and cross currency swaps.

Wesfarmers has considered the likely operational and accounting outcomes from the proposed changes to hedge accounting in the ED. The key elements of the proposed changes are seen as an improvement on the current standard. However, Wesfarmers has some concerns over other changes proposed in the ED. This letter summarises our concerns and suggested changes to the final standard in relation to:

1. the increase in disclosures for questionable benefit;
2. the increase in earnings volatility relating to own credit risk;
3. offsetting fair value hedges in the statement of financial position; and
4. additional guidance and flexibility be provided in relation to operational interruptions.

The increase in disclosures for questionable benefit

Feedback Wesfarmers has received from analysts confirms that sufficient detail is already provided to the market in relation to Wesfarmers hedging activities. Information currently provided by Wesfarmers through investor briefings is more frequent, timely and targeted than the prescriptive disclosures proposed in the ED. Wesfarmers questions the benefit of increasing the level of disclosure in the annual report from that already required under AASB 7.

The prescriptive nature of the additional disclosures proposed in the ED will drive an increase in the quantity of disclosure, rather than the quality. This is consistent with feedback received in relation to the current AASB 7 disclosures which are detailed and prescriptive, but do not provide useful information to users. Additional time and resources will need to be spent preparing, reviewing and auditing the extensive disclosures for questionable benefit. Wesfarmers encourage further discussion with sophisticated analysts on the purported benefits of the proposed changes and whether the prescriptive disclosures proposed in the ED would enhance understanding of the company's hedging activities.

The increase in earnings volatility relating to own credit risk

Wesfarmers encourages the Board to consider the treatment of ineffectiveness arising from own credit risk, particularly on derivatives. The key concerns surrounding own credit risk are:

- valuing own credit risk results in a counter-intuitive outcome whereby an improvement in our own credit worthiness results in recognition of a fair value loss in earnings and vice versa;
- recognising own credit risk in the income statement adds unnecessary earnings volatility as realised fair value movements over the life of the hedge are in effect nil; and
- valuation of own credit risk is subjective.

Wesfarmers proposes that, in the event that own credit risk be included, a similar treatment to IFRS 9 *Financial Liabilities* be adopted. For liabilities in effective hedge relationships, the fair value attributable to own credit risk should be recognised separately in other comprehensive income, rather than earnings.

Offsetting fair value hedges in the statement of financial position

We believe understanding of the impact of fair value hedging would be enhanced through offsetting the hedging item and hedging instrument in the statement of financial position. For investor presentation purposes, Wesfarmers restate the balance sheet to offset fair value hedges to provide users a more accurate reflection of the company's position. This is also consistent with information reported to management internally. By showing the position net of offsetting fair value hedges, balance sheet movements represent only 'real' movements, being cash movements or movements in fair values that would be realised if the balance was settled. Additional detailed disclosures could be included in the notes to the accounts for any users interested in that level of detail.

Additional guidance and flexibility be provided in relation to operational interruptions

Wesfarmers recommends that additional guidance be provided in relation to amending a portfolio of cash flow hedge transactions, covering the company's operations, where an unexpected event causes a significant temporary interruption to those operations. Clarity is required around the concepts of 'highly probable' and 'delayed transactions', and under what circumstances hedge accounting can continue to be applied where an operational event has impacted the timing of hedged cash flows. In addition, greater flexibility should be provided to allow the company to amend its portfolio of cash flow hedges to adjust for operational interruptions, provided any changes are consistent with the company's risk management objectives and hedging activities.

Our detailed responses to the questions raised in your ED are contained in the Appendix to this letter.

If you have any questions regarding this submission, please do not hesitate to contact Judd Greenway on +618 9327 4275.

Yours sincerely,



Judd Greenway
General Manager Group Accounting
Wesfarmers Limited

Encl: APPENDIX – WESFARMERS' RESPONSE TO HEDGE ACCOUNTING EXPOSURE DRAFT

Question 1: Objective of hedge accounting

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 proposed overall objective of closer alignment between risk management objectives and hedge accounting. However, we question the value of increasing existing disclosure requirements and believe this will be of questionable benefit resulting in an increase in the quantity rather than quality of disclosures.

Question 2: Instruments that qualify for designation as hedging instruments

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. Provided a non-derivative financial asset or liability is used to mitigate a specific risk, consistent with the company's risk management objectives, these instruments should qualify as eligible hedging instruments.

Question 3: Derivatives that qualify for designation as hedged items

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. The ability to hedge exposures, including aggregated exposures, rather than specific designated items is consistent with how the exposures are managed internally. From a risk management perspective, the method by which the risk exposure is generated, either through a direct exposure such as floating rate AUD debt or an aggregated exposure such as synthetic floating rate AUD debt arising from a cross currency interest rate swap, does not change the company's economic exposure or its risk management objective.

Question 4: Designation of risk components as hedged items

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. Risk components should be eligible to be designated as hedged items for both financial and non-financial items as this will allow the accounting to be more reflective of the company's risk management activities.

Question 5: Designation of a layer component of the nominal amount

(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. Hedging a layer or portion of a nominal exposure is a common risk management strategy. Therefore, the ability to hedge a layer or portion of the nominal amount more closely aligns hedge accounting with risk management activities.

Question 6: Hedge effectiveness requirements to qualify for hedge accounting

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. As the more principles based approach adopted in the ED has removed the prescriptive 80-125 per cent test requirement, the qualifying criteria is appropriate in defining the basis of the hedge and measuring its alignment with the company's risk management objectives. The requirements outlined in the ED will help ensure that the risk being hedged and the instrument used are appropriate and expected to be effective.

Question 7: Rebalancing of a hedging relationship

(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?

We agree with the rebalancing provisions proposed in the ED.

(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. Proactively rebalancing will allow for better alignment between hedge accounting and risk management.

Question 8: Discontinuing hedge accounting

(a) Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedge relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedge relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?

We agree that hedge accounting for hedges no longer meeting the requirements should be discontinued.

(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 with the proposed treatment.

Question 9: Accounting for fair value hedges

(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?

We agree. However, Wesfarmers encourage the Board to consider the treatment of ineffectiveness arising from own credit risk, particularly on derivatives. The key concerns surrounding own credit risk are:

- Valuing own credit risk results in a counter-intuitive outcome whereby an improvement in our own credit worthiness results in recognition of a fair value loss in earnings and vice versa;
- Recognising own credit risk in the income statement adds unnecessary earnings volatility with realised fair value movements over the life of the hedge are nil; and
- Valuation of own credit risk is subjective where the company's debt is not actively traded on a quoted market index or debt raisings are infrequent.

Wesfarmers propose that, in the event that own credit risk be included, a similar treatment to IFRS 9 *Financial Liabilities* be adopted. For liabilities in effective hedge relationships, the fair value attributable to own credit risk should be recognised separately in other comprehensive income, rather than earnings.

(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?

We disagree with presenting the gain or loss on the hedged item as a separate line item in the statement of financial position. Consistent with the Board's original position (BC 122), we believe that separate disclosure adds complexity and that fair value movements do not typically warrant separate disclosure. We believe that disclosure in the notes to the accounts is sufficient.

For effective fair value hedge relationships, such as foreign currency debt, and where there is an intention and history of maintaining the relationship to maturity, Wesfarmers propose that the hedged item and hedging instrument should be allowed to be offset in the statement of financial position. This will ensure that the balance sheet shows only the net exposure with detail provided in the notes to the accounts. For investor presentations, Wesfarmers restate the balance sheet to offset fair value hedges to provide investors a more accurate reflection of the company's position. This is also consistent with how information is reported to management internally. By showing the position net of offsetting fair value hedges, balance sheet movements represent only 'real' movements (being cash movements or movements in fair values that would be realised if the balance was settled). Additional detailed disclosures can be provided in the notes to the accounts for any users interested in that level of detail.

(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 linked presentation is not the best method for presenting fair value hedges. Please refer to our proposed treatment discussed in 9(b).

Question 13: Disclosures

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

We disagree. Feedback Wesfarmers has received from analysts confirms that sufficient detail is already provided to the market in relation to Wesfarmers hedging activities. Information currently provided by Wesfarmers through investor briefings is more frequent, timely and targeted than the prescriptive disclosures proposed in the ED. Wesfarmers questions the benefit of increasing the level of disclosure in the annual report already required under AASB 7. This is consistent with feedback outlined in the IASB staff paper where it was noted that most analysts used information provided by management to understand the effect of the entity's hedging activities and were comfortable relying on management to provide this information.

We consider that the prescriptive nature of the additional disclosures proposed in the ED will drive an increase in the quantity of disclosure, rather than the quality. This is consistent with feedback received in relation to AASB 7 disclosures which are detailed and prescriptive but do not provide useful information to users. Additional time and resources will need to be spent preparing, reviewing and auditing the extensive disclosures for questionable benefit. Wesfarmers encourages further discussion with sophisticated analysts on the purported benefits of the proposed changes and whether the prescriptive disclosures proposed in the ED would enhance understanding of the company's hedging activities.

Question 16: Effective date and transition

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

We disagree. Companies should be allowed to revise hedge relationships adversely impacted by the current standard to take advantage of the more flexible arrangements under the ED.

Additional comments

Additional guidance and flexibility be provided in relation to operational interruptions

Wesfarmers recommends that additional guidance be provided in relation to amending a portfolio of cash flow hedge transactions, covering the company's operations, where an unexpected event causes a significant temporary interruption to those operations. For example, Wesfarmers experienced a significant weather event that caused flooding of its coal operations, as well as interruption to rail and port infrastructure. Operations were significantly impacted for approximately one month with rail infrastructure impacted for a longer period. Current guidance on the impact of this event in relation to hedge accounting was unclear.

Clarity is required around the concepts of 'highly probable' and 'delayed transactions' and under what circumstances hedge accounting can continue to be applied where an operational event has impacted the timing of hedged cash flows, particularly where that impact is for a significant length of time. In addition, greater flexibility should be provided to allow the company to amend its portfolio of cash flow hedges to adjust for operational interruptions provided any changes are consistent with the company's risk management objectives and hedging activities.

We believe this would better reflect commercial outcomes and propose this is allowable in certain circumstances where:

- the change in operations is temporary;
- amended hedge transactions still affect the same financial period as the original transactions;
- transactions remain matched by an underlying item; and
- the amended portfolio is consistent with the company's risk management objectives.