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International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

9 March 2011

Dear Sir / Madam

**ED/2010/13 Hedge Accounting**

The Chartered Institute of Management Accountants (CIMA) is pleased to have the opportunity to comment on this consultation. CIMA, founded in 1919, is the world's leading and largest professional body of Management Accountants, with 172,000 members and students operating at the heart of business in 168 countries. CIMA is committed to high quality, global, principle-based, neutral financial reporting standards and supports the widespread adoption of International Financial Reporting Standards.

We understand the need to sub-divide the work of replacing IAS 39 into manageable portions but, once the separate projects have reached conclusions, we would urge the Board to expose the complete IFRS 9 for comment prior to final approval.

CIMA believes that one way in which corporate reporting can be improved is with greater alignment of internal and external reporting. We welcome the Board's proposal to link hedge accounting with the entity's internal risk management policies as this will help to remove the situation where entities are managing risks effectively in practice but not able to reflect this in their financial statements due to the criteria in IAS 39.

We would not like to see a situation where companies can choose either to adopt or not adopt hedge accounting. If the management policy is to use financial instruments to hedge and manage risk they should reflect that in the financial statements through hedge accounting - if the hedging strategy is then ineffective the ineffective element should be recognised in the income statement. If however the management policy is to use derivatives for speculative purposes this should be reflected in the financial statements.

We attach responses to your specific questions and would be pleased to discuss with you any aspect of this letter that you may wish to raise with us.

Yours sincerely

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## **Responses to the specific consultation questions :**

### **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 welcome the general direction of the proposed objective to represent, in the financial statements, the effect of an entity's risk management activities but we do not believe the effect should be restricted to those risks that affect profit and loss only. Risk management activities in relation to items that may impact other comprehensive income or equity should also be able to use hedge accounting principles.

### **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?

The ability to use non-derivatives is welcomed as a principal based system should not arbitrarily reduce bona fide risk management techniques. However, we believe that its application will be limited.

### **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 may be designated as a hedged item.

### **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?

We agree that an entity should be allowed to designate a risk component as a hedged item, provided that the risk component is separately identifiable and reliably measurable. However, we do not welcome the specific exclusion of inflation in BC18 as we would prefer to rely on the professional application of principles rather than foster a rules based system.

### **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 welcome the ability to designate a layer of the nominal amount as the hedged item. Exclusion of prepayment options is understandable but these should be allowed where a group or portfolio is sufficiently large.

#### 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?

CIMA welcomes the proposed removal of the 80 to 125 per cent test for assessing and measuring hedge effectiveness and its replacement with criterion linked to the entity's risk management strategy.

We believe that there is a risk that 'effectiveness' is defined too tightly. There is a risk that the use of the words 'minimise' and 'unbiased' is too strong and we believe that many valid IAS 39 hedges which have high effectiveness may not pass the new standard if applied as worded.

#### 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 believe that rebalancing should be voluntary not mandatory. If the entity does not rebalance for risk management purposes then accounting should not try to force a rebalancing. Operational complexity of rebalancing (geography of accounting entries etc) could outweigh its usefulness.

#### 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?

a) Entities should not be allowed to switch items in or out of hedge accounting unless this reflects a genuine change in the risk management policy.

b) We see no valid reason why an entity should be allowed to discontinue hedge accounting for a hedging relationship that still meets the risk management strategy on the basis for which it qualified for hedge accounting.

#### 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?

a) We agree with the proposed treatment as this seems to best reflect the aim of a risk management strategy that uses hedge accounting to manage profit or loss volatility.

b) Recognising the need to simplify already complex financial statements we would prefer that a single net value is included on the face of the statement of financial position with disaggregated figures presented in the notes to the financial statements sufficient for a proper understanding of the hedged items and the associated gains and losses related to those items.

c) We agree that linked presentation should not be allowed for fair value hedges. We believe that to allow linked presentation would unnecessarily add to the complexity of the financial statements.

#### 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?

This proposal is welcomed but we fear that it may add complexity for many users as isolating time value changes are not trivial.

#### 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 believe that this question should be deferred until the Board has brought forward proposals for portfolio hedge accounting.

#### 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?

We believe that this treatment will make corporate reports even more complex.

**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 with the disclosure categories which present an effective framework for an entity to provide users with an understanding of its risk management strategy and hedging activities. There is a risk that the disclosure requirements will be unduly complex for those with significant hedge accounting due to the need to list every instrument.

**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?

This may be a problem for some corporates.

**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?

In our opinion the IASB must come up with a suggestion for this fundamental hedging requirement. We consider option 3 to be the least worse but compromising fair value option is not sensible and a hedge accounting solution producing a similar result could be found if Board are willing to compromise a little on separately identifiable or reliably measurable.

**Question 16**

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

We support an effective date of 1 January 2015 for all phases of IFRS 9.