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Exposure Draft ED/2010/13 Hedge Accounting

Dear Sir/Madam,

Thank you for the opportunity to comment on your Exposure Draft ED/2010/13 Hedge Accounting. The Volkswagen Group is one of the world's leading automobile manufacturers and the biggest carmaker in Europe. The Group currently operates 62 production plants in fifteen European countries and a further six countries in the Americas, Asia and Africa. Around the world, nearly 400,000 employees produce about 26,000 vehicles or are involved in vehicle-related services each working day. The Volkswagen Group sells its vehicles in more than 153 countries. With our 100%-owned subsidiary Volkswagen Financial Services AG we are also the largest automobile financial services provider in Europe. On behalf of Volkswagen AG, Wolfsburg, we are pleased to provide you with the requested remarks to the proposed Exposure Draft in response to your invitation to comment.

The Exposure Draft includes a number of improvements that lead to the fact that hedge accounting will represent the entities risk management activities more realistically. We welcome the proposed objective of hedge accounting (e.g. that the reality of risk management is responsible for hedge accounting). In our view hedge accounting should not have impact on whether and how hedging transactions are received. Overall, the proposes bring more flexibility and thus more use of hedge accounting. Particularly it is a consequence of the discontinuation of the rigid limitations in IAS 39.

We also welcome the efforts of the IASB to reduce the complexity of hedge accounting, as risk management and hedging principle already have a high complexity. This raises the question why new and additional rules are created which unnecessarily increase this complexity (particularly given in the case of the commitment to rebalancing).

Concerning the questions we present the following key statements:

- * We welcome the eligibility of hedged items and hedging instruments, especially the designation of specific risk components, non-derivative financial assets or group of items. In different cases we see no sufficient reasons for exceptions (i.e. non-derivative financial instruments other than measured at fair value through profit or loss, credit risks components etc). In our opinion, excep-

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tions lead to the point that the objectives of hedge accounting would not be achieved.

- ® The elimination of the 80 to 125 per cent-bright line and the use of quality criterias are substantial improvements to requirements of effectiveness testing. This will bring more flexibility and more use of hedge accounting, but also leaves room for interpretation.
- In our opinion the proposes to fair value hedges do not lead to a reduction of complexity (for addressees and preparers).
- Furthermore there will be more unnecessarily increases of complexity, especially in the commitment to rebalancing.

Below we address the issues which are of special relevance to us:

Q1: Objective of hedge accounting

In our opinion, hedge accounting should reflect the circumstances and the effectiveness of risk management activities and give insight into the purpose and design of security relations. The Exposure Draft implements these requirements and thereby seeks to reach a compromise between the link of risk management and financial reporting and the avoidance of "accounting mismatches". We are aware that a principle-based approach leads to interpretation problems in many cases. The problem might be in particular that due to different degrees of freedom in some cases only a partial picture of risk management is presented (different restrictions and voting rights in the designation of hedging instruments and hedged items). This means, in these cases the objective of hedge accounting would not be achieved and therefore remains the criticism of the current IAS 39. Nevertheless, we believe that regulatory requirements should also be practicable and in an acceptable benefit-cost ratio. We do not consider that a rule-based approach will achieve better results.

Q2: instruments that qualify for designation as hedging instruments We welcome the extension of the range of eligible hedging instruments to non- derivative financial instruments, as an entity's risk management is better illustrated. We understand the IASB intention to generally limit the range to those instruments measured at fair value through profit or loss in order to avoid measurement problems. For example equity instruments whose performance has been previously recognized in the other comprehensive income should not be allowed to be used as hedging instruments, due to recycling restrictions. However, these restrictions also lead to the fact that certain parts of the risk management of an entity are not presented in the financial statement and so the objectives of hedge accounting can not be achieved. Therefore, we believe that non-derivative instruments other than those at fair value through profit or loss should be eligible as hedging instruments.

Q3 to Q5: Designation hedged items

Since the proposes have the aim to represent risk management activities in financial statement, we see no reason why synthetic exposure or layer can not serve as a hedged item in a hedging relationship. We also welcome the proposal to allow individ-

ua! risk components as hedged item if they are separately identifiable and measurable. In our view it was an unnecessary restriction within the hedge accounting under IAS 39. Such restrictions could cause that entities do not assume certain economically meaningful transactions (e.g. synthetic exposure) for reasons of balance-sheet figure. Our advice therefore is not to exclude certain risks, when there are no sufficient reasons for exceptions (e.g. non-contractual specified inflation).

Q6: Hedge effectiveness requirements to qualify for hedge accounting A major problem in the hedge accounting has been the achievement of certain thresholds in the effectiveness testing. In particular the discontinuation of a hedging relationship was necessary, if it failed to achieve the required threshold of 80 per cent. With the introduction of an objective-based approach the 80 to 125 per cent test has been eliminated. In our view, this is the substantial improvement in hedge accounting. But the use of quality methods for assessing effectiveness also leaves room for interpretation. Accordingly the comparability of financial statements may be limited, especially when several entities have established their risk management on different parameters.

Q7 and Q8: Rebalancing of hedging relationship and Discontinuing hedge accounting We understand the IASB intention to prevent sequential discontinuing and restarts of hedges, if the objectives of risk management remain the same. However, we believe that a commitment to rebalancing is not effective here. In particular the concept of rebalancing is poorly operationalized at the moment. We believe that many companies will have difficulties in terms of complexity of implementation. Therefore we think it should be allowed to discontinue hedge accounting voluntarily, as long as there are no precise guidelines for implementation. In our opinion, a commitment to rebalancing in its present form will lead to error-prone accounting.

Q9: Accounting for fair value hedges

We understand the argument that the effect of micro hedges should only be presented in one place of the financial statement (i.e. in other comprehensive income). We also see the intention that only a single method of hedge accounting is required (first step). Until now for open portfolio hedge accounting the current regulations in IAS 39 remain unchanged (we welcome the continuation of the discussion about open portfolio hedge accounting). We believe this dual approach for the accounting of the effective part of "fair value" hedges (OCI vs. P&L) is confusing for the users of the financial statements. Since inefficiency continues to be recognised in profit and loss, there is also no change compared to IAS 39 (second step). We wonder if these "simplifications" to the addressees exceed the costs of the preparers to meet these requirements. In addition, we believe every further information on hedge accounting should not be presented in the financial or income statement. The hedging strategies and other informations should be explained in the notes. Therefore, we are against the use of separate line item presentation or linked presentation, as they compromise the clarity and thus do not improve the understandability of the financial statement.

Q10: Accounting for the time value of options for cash flow and fair value hedges We agree with the proposals. Regarding the method of realization of the time value, we would prefer the use of one single method. The reduction of complexity weighs more than the differentiation in treatment-related and period-related hedge transactions. An allocation over the relevant period seems useful.

AKTIEINGESSELLSCHAFT

Q11 and Q12: Hedges of a group of Items

We welcome the eligibility of groups of items as a hedged item. We agree that hedge accounting for relationships other than between a single hedging instrument and a single hedged item should be permitted. Besides, the commentation of these questions is difficult for us, as macro hedging is generally not covered in this exposure draft.

Q13: Disclosures

As explained above, the notes play an important role to understand hedge accounting of an entity. We agree with the proposals.

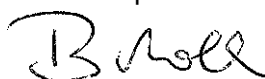
Q14 and Q15: Accounting alternatives to hedge accounting N/A

Q16: Effective date and transition

As explained in our comment to Exposure Draft: Effective and transition method, the earliest application date is the year 2015. We support the prospective application of the proposals.

Best Regards,

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A handwritten signature in black ink, appearing to read 'B. Bartolke'.

Dr. Ingrid-Ulla Bartolke