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2 March 2011

Dear Sir David,

**Feedback on Exposure draft    Hedge Accounting**

We are privileged to respond to your invitation to comment on the above Exposure Draft.

In general, we broadly support the Board's views and also the Board's endeavor in making broad-sweeping changes to the current hedge accounting requirement so as to make the application of hedge accounting easier and better reflecting a preparer's risk management activities.

Our feedback and views are set out in the Appendix to this letter.

Thank you for your constant effort to perfect the exposure draft and finally make it get publishing.

Kindly contact Mr Hu Jianzhong PetroChina Company Limited, Finance Department at +86 10 5998 6155 in relation to any questions you may have on the contents of this letter. Email: [hujzh@petrochina.com.cn](mailto:hujzh@petrochina.com.cn)

Yours sincerely

Mr Zhou Ming Chun

Chief Financial Officer  
PetroChina Company Limited

## 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?

### **Our views**

We agree with the objective of hedge accounting as noted in the Exposure Draft which we believe cannot be achieved through the following limitations in the relatively complex IAS39:

- Not allowing hedging on a component of qualifying hedged item
- Not allowing a derivative to be designated as a hedged item
- A hedge is expected to be highly effective (a strict qualifying criterion of 80%-125%)

Meanwhile, we think the proposal will be helpful in:

- Allowing the hedge accounting to be more closely with risk management activities of a preparer.
- Establishing an objective-based approach to determining hedge effectiveness
- Addressing specific problems noted by constituents with the existing IAS39

## 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?

### **Our views**

In general and consistent with our response to Question 1, we support the Board's efforts in putting forward improvements to hedge accounting with a view to enable preparers to better reflect their risk management activities in their financial statements. Through a principle-based (rather than rule-based) model, the Board hopes to promote a better alignment of hedge accounting with risk management activities undertaken by preparers in hedging financial and non-financial risks.

In connection with the foregoing, we support the Board's proposed departure from IAS 39's bright line approach to defining highly effective hedging both prospectively and retrospectively. In particular, we believe the proposed replacement of the 80% - 125% high hedging effectiveness requirement with an objective-based assessment would enhance the linkage between hedge accounting and the preparer's risk management activities as the bright line is sometimes regarded as arbitrary and onerous.

We also support the proposal to eliminate the requirement to assess the effectiveness retrospectively as this will minimize the need to de-designate hedging relationships which fail the retrospective hedge effectiveness test subsequently.

We believe that the combination an objective-based hedge effectiveness assessment and not focusing on identifying accident offsetting represents a sufficiently rigorous hedge effectiveness assessment that is practical to apply.

We anticipate that proposed hedge effectiveness assessment criteria may reduce the burden on preparers in relation to the application of hedge accounting.

However, we do have the following concerns with respect to the proposed hedge effectiveness assessment criteria:

a) As the hedge effectiveness assessment criteria is now principle based, inadvertently its application may be prone to subjective interpretation.

As an illustration of the foregoing, the notion of “other than accidental offsetting” in paragraph 19(c)(ii) of the Exposure Draft may be subject to different interpretations, depending on an entity risk management policies. While we noted that paragraph B31 of the Exposure Draft attempts to provide further discussion on “other than accidental offsetting”, we believe a more explicit (and quantitative) definition of the notion of “other than accidental offsetting” may be useful.

b) We believe that, consistent with the objective of the Board to better align hedge accounting with risk management activities undertaken by preparers in hedging financial and non-financial risks, it would be necessary to establish a correlation between a preparer’s risk tolerance thresholds and the consequent extent of hedging.

In this regard, defining the objective of hedge effectiveness around ensuring that a hedging relationship that will produce an unbiased result (and minimise expected hedge ineffectiveness) may not always be congruent with the Board’s stated objective for developing a new hedge accounting model.

c) We hope that the Board will provide further application guidance that will facilitate preparers in applying the criteria for assessing hedge effectiveness and thus promoting consistent application of hedge accounting by different preparers.

For example, the proposals should define the term critical terms of a hedging instrument and hedged item, as well as explain the meaning of their close alignment.

See also our response in (a) above.

d) With the new notion of hedge effectiveness and regardless for any documentary evidence of hedge effectiveness (as a fundamental requisite prior to applying hedge accounting), we anticipate that the proposal will necessitate changes in management information and financial reporting systems and procedures for preparers.

The replacement of a bright-line quantitative with an objective-based hedge effectiveness assessment coupled with a need to ensure consistent application of the proposed hedge accounting criteria, we believe it is necessary for the Board to provide more detailed guidance or illustrative examples with respect to documentation requirements beyond that currently discussed in paragraphs 19 (b) and B39 of the Exposure Draft.

### 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?

#### Our views

(a) We urge the Board to further deliberate whether the proposed disclosures in financial statements can effectively reflect the risk management activities of an entity. At the same time, the Board should also in finalising the Exposure Draft, harmonise the like disclosures promulgated by various regulators and stock exchanges with a view to helping preparers make multiple disclosures.

(b) We suggest the Board to clarify the positioning of risk management objective and strategy for undertaking hedging in financial statements, that is whether in footnotes or risk management.

(c) To avoid incomparability in disclosure of information caused by different understanding of disclosure requirements, we suggest the Board to provide more specific requirements or illustrations with respect to disclosures.

(d) The disclosures requirement of the entity's hedging activities that affect the amount, timing and uncertainty of its future cash flows should determine in accordance with the important Level, avoiding mislead the users.

**Other suggestion:**

1. In practices, it is hard to prepare a one to one risk management file of hedge to hedging relationships. The Exposure Draft requires that at the inception of the hedge there is formal designation and documentation of hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. In practice hedging strategy is often determined at a macro level, an entity should adhere to such a hedge strategy and the attendant controls and procedures, instead of preparing complex document for each hedge transaction. We suggest the Board to release more guidelines, in addition to that set out in paragraphs 19 and B39.

2. We suggest the Board to more extensively consider the very dynamic nature of hedging in practice, in order to better achieve the objective of hedging accounting. The main objective of hedging activity is to manage the risks, the objectives and also the relationships of hedging need to be amended frequently due to the constant changes in the global market environments. Whilst the Exposure Draft allows an entity to rebalance the hedging relationship provided that the risk management objective unchanged. We suggest the Board consider allowing an appropriate modification to the hedge objectives . For example, an entity's objective of risk management through hedge activity is net exposure risk of physicals during certain period. Can the entity continue using hedge accounting through rebalancing the hedge relationships, instead of stopping using it.