

March 11, 2011

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

**Re: Proposed Accounting Standards on Hedge Accounting File Reference No.
ED/2010/13**

Dear Sir David Tweedie:

The Association for Financial Professionals (AFP) appreciates the opportunity to comment on the Exposure Draft on Hedge Accounting issued December 2010 (the “ED”). AFP represents approximately 16,000 finance and treasury professionals from over 5,000 U.S. and multinational corporations, including the Fortune 1,000 and the largest of the middle market companies. These members are responsible for the protection and management of corporate cash, cash flow requirements and corporate investments. AFP membership also includes controllers and chief financial officers who are responsible for their corporate accounting, financial reporting and regulatory compliance. Finally, our affiliate, AFP of Canada, includes a significant number of Canadian finance and treasury professionals who are now subject to the financial reporting requirements under IFRS.

AFP members recognize that in this globally competitive market environment consistency in financial reporting can best be achieved through convergence by creating unified global accounting standards. As you are aware, FASB has recently solicited feedback from its U.S. constituents on this exposure draft in an effort to begin the convergence process. Thus, AFP believes it is in the best interest of its members to be proactively involved in both the FASB and the IASB’s deliberations to ensure that their comments are considered.

AFP members understand and support IASB’s efforts to provide financial statement users with a more timely and representative depiction of an entity’s involvement in financial instruments, while reducing the complexity in accounting for those instruments. They also understand the importance of providing the most useful, transparent and relevant information to investors about the financial assets and financial liabilities of a reporting entity. Thus, we have several comments that we wish to share with you on this proposal.

Better Alignment of Model with Management's Risk Objectives

AFP strongly believes that the overarching objective of the financial statements is to reflect how a company is managing shareholder resources over the course of the reporting period. Likewise, the objective of hedge accounting is to accurately reflect how effective management is at managing its risk in accordance with its stated objective. The current hedge accounting model has been prescribing the way management will mitigate its risk rather than describing management's effectiveness of risk mitigation. Thus, AFP appreciates your efforts to realign the hedge accounting model to more closely parallel how a company meets its risk management objectives.

Effort to Reduce Complexity

Corporate treasurers consider hedging as a viable risk mitigating tool that can be used to manage their cash flow requirements. However some corporate treasurers, including those at nonpublic entities, have decided not to take advantage of this accounting method because of the accounting complexities that accompany its use. Specifically, the onerous documentation and reporting requirements to qualify for hedge accounting, the potential earnings impact when hedge is no longer highly correlated to the hedge exposure, and the penalties associated with violations of the hedge accounting rules.

Management at nonpublic companies are not as concerned about earnings volatility as it relates to share price, rather what is the effect of earnings on the company's cash flow and whether there is any potential risk to their ongoing mission. Thus, many nonpublic entities believe that the costs of engaging in hedge accounting (e.g. specialized staffing, consultants, system upgrades, etc.) outweigh the benefits. As a result, many elect to not engage in hedge accounting.

Likewise, the same holds true for some public entities as well. Many public entities would rather economically hedge their risk exposure, and thus take the charge to earnings to than take advantage of hedge accounting. Like the nonpublic entities mentioned previously, these public entities believe that the capital outlay that the company would have to expend to account for this complex standard outweigh the benefits.

Shift to Objective Based Hedge Effectiveness Assessment

AFP members support your decision to move from a hedge assessment of highly effective (thus eliminating the "bright line" effectiveness range of 80-120 percent) to an objective-based hedge effectiveness assessment. However, we are not certain that your proposed model meets your stated objective to simplify hedge accounting. Par. 19(c) of the proposal indicates that a hedging relationship meets the hedge effectiveness requirements if it:

- (i) meets the objective of the hedge effectiveness assessment; and
- (ii) is expected to achieve other than accidental offsetting.

Par. B31 indicates that an entity should assess whether the expected offsetting between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flow is other than accidentally by analyzing the economic relationship between the hedged item and the hedging instrument. This includes an analysis of the possible behavior of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. While this is a change in the current assessment of ineffectiveness, it creates another level of complexity as the outcome will result in a new ongoing quantitative assessment of the hedge position.

We urge the IASB to consider the FASB's proposed model for assessing ineffectiveness. The FASB's proposal also reduces the criteria from highly effective to reasonably effective but their proposal requires a reassessment only when circumstances change that would trigger a reassessment. As we commented to the FASB, more clarification on what is considered reasonably effective should be given. The final standard should include scenarios where obvious sources of ineffectiveness exist, but can be dismissed based on qualitative factors.

Rebalancing vs. De-designation

Both the IASB and the FASB's current hedge accounting model requires automatic discontinuation when the hedging relationship fails the effectiveness assessment test or where the hedged item and hedging instrument fail to meet the other qualifying criteria. The current mandatory de-designation of a hedged position introduces unwanted volatility in the income statement.

As an example, a company may have floating rate debt swapped into fixed in order to gain hedge accounting. The documentation might reference the swap to the specific debt issuance versus generic floating rate debt. If the company changes strategy and elects to prepay debt more quickly, the company cannot reassign the hedge to other debt and retain hedge accounting status. The hedge must be de-designated and effectively becomes a long term liability that will have an immediate income statement impact.

Your proposed model would allow AFP members other options, such as applying a layered hedge approach to minimize the income statement impact. Rather than applying the hedge to the entire instrument, a company has a choice to do a partial designation that may allow the hedge to survive without losing the whole designation.

The proposal also would offer companies the ability to rebalance the position to obtain the desired hedge outcome versus automatic de-designation if the hedge relationship changes such that it falls outside of the threshold. This ability to rebalance a hedge position gives management more flexibility for effectively managing its risk positions. We also think that the FASB should

introduce this “option” as an alternative in its standard. However, while we support the rebalancing model, we do not support that this model should be mandatory. The decision of whether to rebalance vs. de-designate the hedge should not be dictated by the accounting standard setters. Rather the decision should be made by corporate management after consideration of their overall business objective.

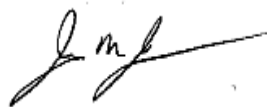
Voluntary De-designation Rescinded

While the proposal has attempted to loosen most of the stringent requirements under IAS 39, it has also added new unwarranted restrictions. For example, while the IASB’s proposal allows a company the ability to rebalance its position, and both the FASB and the IASB lowering the threshold for assessing ineffectiveness, both the IASB and the FASB has now restricted companies’ ability to voluntarily de-designate a hedge position if all of the qualifying criteria of the hedge are still met. We disagree with the IASB and the FASB on this decision.

There are reasons that management may want to de-designate a hedging relationship despite meeting the qualifying criteria. The decision to restrict management’s ability to voluntarily de-designate a hedge position seem to contradict the IASB’s overarching goal of using the accounting as a tool to explain how management was effective in managing its risk. In this case, it reverts back to the accounting prescribing the outcome rather than describing management’s decision-making.

AFP members support the efforts of the IASB to steward the development of high quality accounting standards. Thank you for the opportunity to comment on this Exposure Draft. Please feel free to contact Salome J. Tinker, AFP’s Director of Accounting Policy and Financial Reporting for any additional information and questions at (301) 961-8871 or sjtinker@AFPonline.org.

Sincerely,



June M. Johnson, CPA, CTP
Chair of the AFP Financial Accounting and
Investor Relations Task Force



Joseph C. Meek, CTP
Chair of the AFP Government
Relations Committee

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?

Response:

The Exposure Draft states that the objective of hedge accounting 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. We agree with your stated objective. Hedging is a tool used by corporate treasurers to reduce earnings volatility. Thus, we believe that the objective of hedge accounting is to accurately reflect how effective management was at achieving its overall objective. The accounting should tell the story rather than prescribe the outcome. Currently, because of the strict accounting rules, corporate treasurers are not employing this useful risk mitigating tool. This is a fundamental flaw in the current financial reporting system. AFP applauds your efforts to simplify this guidance in an attempt to allow companies the ability to use all available options to mitigate their risk exposure.

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?

Response

AFP believes that a non-derivative financial asset and a non-derivative liability measured at fair value through profit or loss should also be eligible hedging instruments.

Question 3

Do you agree than 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 would we recommend and why?

Response:

AFP agrees with the proposal. In the case of receiving funding in one currency and swapping it into the functional currency, a treasurer may also want to manage interest rate risk by converting the currency from a fixed to a floating rate (or vice versa). This proposal will allow them to do so.

Question 4

Do you agree that an entity should be allowed to designate as a hedge 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 would you recommend?

Response:

We think that an entity should be allowed to designate as a hedge item changes in cash flows or fair value of an item attributed to a specific risk component provided that the risk component is separately identifiable and reliably measurable. However, we do see the argument that while credit may not meet this definition, it is a significant component in companies' risk mitigation strategy (credit default swaps). As such, the guidance should be further expanded to allow companies the ability to obtain hedge accounting to mitigate credit risk.

Question 5

Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as a hedged item? Why or why not? If not, what changes do you recommend and why?

Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedge item in a fair value hedge if the options' fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

Response:

AFP supports the ability to designate a layer of the nominal amount as the hedged item if such designation is consistent with management's hedge objectives for the item.

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?

Response:

AFP members support your decision to move from a hedge assessment of highly effective, (the "bright line" range of 80-120 percent) to an objective-based hedge effectiveness assessment. However, we are not certain that your proposed model meets your stated objective to simplify hedge accounting. In fact, the proposed changes would create additional complexities.

Par. 19(c) of the proposal indicates that a hedging relationship meets the hedge effectiveness requirements if it:

- (i) meets the objective of the hedge effectiveness assessment; and
- (ii) is expected to achieve other than accidental offsetting.

Par. B31 indicates that an entity should assess whether the expected offsetting between the changes in the fair value of the hedging instrument and the hedged item's fair value or cash flow is other than accidentally by analyzing the economic relationship between the hedged item and the hedging instrument. This includes an analysis of the possible behavior of the hedging relationship during its term to ascertain whether it can be expected to meet the risk management objective. While this is a change in the current assessment of ineffectiveness, it creates another level of complexity as the outcome will result in a new ongoing quantitative assessment of the hedge position.

We urge the IASB to consider the FASB's proposed model for assessing ineffectiveness. The FASB's proposal also reduced the criteria from highly effective to reasonable effective but require a reassessment only when circumstances change that would trigger a reassessment. Consistent with our comments to FASB, AFP is also asking the IASB to provide more clarification on what is considered reasonably effective. The final standard should include scenarios where obvious sources of ineffectiveness exist, but can be dismissed based on qualitative factors.

Question 7

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?

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?

Response:

The proposal also would offer companies the ability to rebalance the position to obtain the desired hedge outcome versus automatic de-designation if the hedge relationship changes such that it falls outside of the threshold. This ability to rebalance a hedge position gives management more flexibility for effectively managing its risk positions. We also think that the FASB should introduce this "option" as an alternative in its standard. However, while we support rebalancing, we do not support that rebalancing should be mandatory. The decision of whether to rebalance vs. de-designate the hedge should not be dictated by the accounting standard setters. Rather, decisions should be driven by corporate management after consideration of their overall business objective.

In addition, rebalancing seems to allow for extensive management judgment with respect to adjusting the deferred amounts in other comprehensive income based upon management's risk assessments. Since rebalancing is a new concept, AFP recommends that the discussion in B47 related to risk management should be expanded and more clearly defined.

Question 8

Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of 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?

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?

Response:

The majority of AFP members do not support the proposed elimination of the ability to de-designate a hedging relationship. This adds operational complexity with the same result still able to be achieved if the instrument is terminated. The decision to restrict management's ability to voluntarily de-designate a hedge position seem to contradict the overarching goal of aligning the accounting to explain how management was effective in managing its risk

A common example of the use of de-designations is the hedge of a forecasted foreign currency (FX) sale on credit. An entity will use an FX forward or option to hedge the sale until the revenue is recognized and a receivable is created. At that point, hedge accounting is no longer necessary as the re-measurement of the FX receivable offsets the revaluation of the derivative. AFP members believe that requiring an entity to terminate the existing arrangement only increases compliance costs and does not serve the goal of hedge accounting simplification. Regardless, should the IASB retain the preclusion against de-designations, we recommend that any entity be permitted to document in its original hedge documentation that hedges may be discontinued as of a specific event (e.g., realization of revenue).

Another example is a company that has an "in the money" derivative and a cash shortfall. Currently the treasurer has the freedom to either close out the derivative with their financial institution or enter into an equal and opposite derivative position. The latter is generally the most cost effective. Thus, the company would need to de-designate the existing swap so that its fair value, as well as that of the new swap, offset in the income statement. However, the risk management objective hasn't changed; the company is still following policy and will enter into a new hedge at current market levels. The current proposal will not allow this strategy.

Question 9

Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognized in other comprehensive income with the ineffective portion of gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?

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?

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?

Response:

AFP believes OCI items should not be utilized for fair value hedges. The gains or losses should not be presented as a separate line item as it is unclear of what would be the added value. However, linked presentation should be allowed for fair value hedges. It is a way of showing how certain assets and liabilities are related but does not net them on the face of the balance sheet.

Question 10

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 (e.g. like a basis adjustment if capitalized 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?

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?

Do you agree that the accounting for the time value options should only apply to the extent that the time value relates to the hedge 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?

Response:

AFP would support accounting the time value of options to the extent that the time value relates to the hedged time and may significantly affect the value. However, the IASB should take into consideration that the process to implement may be quite onerous for smaller less sophisticated entities.

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?

Response:

AFP generally agrees with the eligibility criteria for hedging groups of items. However, it may not work for manufacturing companies. The proposal seems to preclude the ability to hedge the foreign exchange risk in a forecasted sales and purchase on a net basis because there would more likely than not impact profit and loss in different periods, even if the cash flows are expected to be in the same period.

Question 12

Do you agree that for a hedge of a group of items with offsetting risk position that affect different line items in the income statement (e.g. in a net position hedge), any hedging instrument gains or losses recognized in profit or loss should be presented in a separate line form those affected by the hedge items? Why or why not? If not, what changes do you recommend and why?

Response:

AFP generally agrees with this assessment.

Question 13

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

What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

Response:

While AFP supports transparency, we urge the IASB to be mindful that some of the information may be sensitive in nature such as disclosing forward projections of sales of products and services and purchases of commodities and materials, together with details of derivatives

(partially) hedging these (including hedge amounts and hedged rates) which could place the company at a competitive disadvantage, especially those that are not listed or do not report under IFRS.

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 a 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?

Response

AFP agrees with this assessment.

Question 15

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?

If not, which of the three alternatives considered by the Board in paragraphs BC 226-BC246 should the board develop further and what changes to that alternative would you recommend and why?

Response:

AFP believes that derivatives entered into as hedges to manage a company's credit risk should be eligible for hedge accounting treatment under this proposed guidance.

Question 16

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

Response:

AFP agrees with the prospective transition requirements as proposed.
