



March 9, 2011

International Accounting Standards Board  
Via website posting: <http://www.iasb.org/>

Re: Comments in response to IASB Exposure Draft 2010/13: Hedge Accounting

Dear Sir or Madam:

We thank the IASB for the opportunity to comment on this very important topic. Novelis Inc. is the global leader in flat-rolled aluminum rolled products, such as aluminum stock for the beverage can industry. We are a global company with significant operations in Asia, Europe and the Americas. We use commodity, foreign exchange, and interest rate derivatives for risk management purposes, and only after a careful evaluation of the exposure and the degree to which we expect the derivative to effectively hedge the risk.

### 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 agree with the objective as stated in the ED and we believe the proposed objective is a necessary component of a principals based standard. We believe aligning external reporting with internal risk management will provide more transparency in financial reporting. We also believe the objective will serve as an appropriate tool for limiting restrictive or aggressive interpretation of the standards, however we are concerned that strict interpretation by accounting firms and regulatory bodies may persist, absent further clarification and modification.

### 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?*

No opinion

### 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?*

Yes, we support the view that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item. We often manage our risk exposures separately and aggregate exposures once certain risks have been hedged. Consistent with the ED, we believe restrictions on hedge accounting in such scenarios would result in an inability to align risk management objectives and hedge accounting reporting.

### 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 (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?*

Yes, we agree that an entity should be allowed to designate specific risk components as hedged items and we believe the requirement that the risk component be separately identifiable and reliably measurable is reasonable.

As the world's leader in flat-rolled aluminum products, virtually all of our commercial sale agreements contain pricing provisions indexed in a formulaic manner to the published cash price of aluminum on the London Metal Exchange. These provisions often give rise to aluminum price exposures that we hedge with forward contracts indexed to LME aluminum. We have found it to be difficult, and sometimes impossible, under the guidance of IAS 39, to qualify these hedges for hedge accounting because we must consider whether the LME aluminum derivative would be an effective hedge of, for example, general inflation, or the prices of other commodities used in the manufacture of our products.

We believe the current model significantly limits the ability to apply hedge accounting to most commodity risk management activities and we view the current limits as arbitrary when risk components are identifiable and measurable. In our view, without this ability, we will be unable to align our accounting results with the results of our risk management activities.

### 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?*

(a) Yes, we agree that an entity should be allowed to designate a layer of the nominal amount of an item, so long as this approach is consistent with the entity's risk management strategy.

(b) No opinion

### Question 6

*Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what changes do you recommend and why?*

We believe that the proposed changes will have very little impact in practice and may require additional clarification. We prefer the approach taken by the FASB in their exposure draft. They replaced the requirement for a hedge to be 'highly effective' with a requirement that it be 'reasonably effective' and they eliminated the requirement for a quantitative analysis so long as a qualitative assessment could be performed. We believe that it is important for the IASB and the FASB to have convergence in this area.

### 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?*

(a) In general, we support the proposal to allow portfolio rebalancing however we believe the guidance should be permitted rather than required. We believe that allowing rebalancing for hedge accounting purposes should be available when rebalancing is a risk management objective. However, when risk management activities do not result in hedge rebalancing, we do not believe rebalancing for accounting purposes should be required due to the inconsistencies that will result.

(b) Novelis and other companies often hedge baskets of highly similar exposures – such as foreign currency accounts receivable to be paid on different dates – with a single, or a layered derivative position. As we generate new accounts receivable and customers pay old ones, it becomes necessary to periodically rebalance the hedges. We believe that proactive rebalancing may be appropriate in certain circumstances.

## Question 8

*(a) Do you agree that an entity should discontinue hedge accounting prospectively only when the hedge relationship (or part of a hedge 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 hedge 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) No, we believe there are cases where the company's risk management strategy could include discontinuing hedge accounting prematurely. We believe that this should be allowed, provided management has described, in sufficient detail at the inception of the hedge, the risk management purpose for discontinuing hedge accounting prematurely and the precise future conditions that would need to exist in order to do so. The company must then discontinue hedge accounting prematurely when and if such conditions are met.

(b) See (a) above

## 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 do not believe that there is a compelling need to change the existing mechanics of fair value hedge accounting to include gains and losses in OCI.

(b) We do not agree that the gain or loss of the hedge item attributable to the hedged risk should be presented as a separate line item in the statement of financial position. We believe that this may clutter the primary financial statements depending on the number of hedging relationships entered into by the entity. We believe such information is better presenting in the notes.

(c) We agree that linked presentation should not be allowed for fair value hedges because we believe that presenting linked information on the face of the financial statements may ultimately be confusing to the users of 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 (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?*

No opinion

### 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?*

Generally, we agree with the Board's criteria for the eligibility of groups of items as a hedged item. We believe that these criteria are more aligned with the risk management practices of an entity. However, we have concerns regarding the criterion that offsetting cash flows in a group of net positions must affect profit or loss in the same reporting period. We believe this restriction is often inconsistent with risk management objectives and is unnecessary. We believe cash flow risk management often does not focus on the timing of when profit or loss is recognized for accounting purposes but rather focuses on the timing of the economic exposure (ie transactions or cash flows).

### 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 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. However, we believe the IASB should clarify that in such situations hedge accounting can be applied to a gross position, even if the risk is managed at a net level. To this end, we believe that the board should provide additional guidance in this area to clarify that grouping or netting of exposures for hedge accounting purposes is not required.

### 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?*

No opinion

#### **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?*

We believe that if contracts are managed under a fair value based risk management strategy, derivative accounting might present an opportunity to eliminate volatility without the need to fulfill the onerous hedge accounting documentation requirements.

#### **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?*

No opinion

#### **Question 16**

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

No opinion

#### **Additional points**

There are few other concerns that we would like to highlight:

We believe that the major failing of IAS 39 has not been the complexity of the standard, but rather the high burden placed on companies who want to apply hedge accounting to valid risk management activities. A significant number of industrial companies choose not to apply hedge accounting because it is too difficult and costly. Their financial statements show the one-sided impact of gains and losses from derivative positions, without the offsetting effect of the items being hedged. We believe that the needs of the users of financial information are poorly served when such a condition exists.

An area of concern not addressed by the exposure draft regards the standards for high probability for forecasted transactions. Novelis often face risks whose ultimate occurrence involves some uncertainty. Our risk management policies require that we hedge these risks based on projected scenarios believed to be “most likely”. Existing rules do not make sufficient accommodation for the uncertainty of business and appear to be inconsistent with other specified sections of the ED. We are especially concerned with paragraph B65(b) and the idea of a one-sided look back. We believe an entity should be able to consider the complete history of forecasted transactions (both accurate and inaccurate) when assessing the ability to accurately forecast highly probable future transactions, for example the percentage of accurate forecasts may be a more appropriate metric (ie 95% of forecasts are accurate). We believe that highly probable is not synonymous with absolute certainty and we believe the idea that all forecasts are tainted due to the inaccuracy of a small percentage is inconsistent with the proposed objective of the ED and a principals based standard.

Our auditors are fond of saying, “hedge accounting is a privilege, not a right.” We recognize that many of the provisions of IAS 39 were intended to reduce the opportunity for accounting abuses. However, we believe strongly that presenting fairly and transparently an entity’s financial position and the changes therein is management’s responsibility, not a privilege. We applaud many of the changes proposed by the exposure draft that, in our opinion, lower several of the ‘barriers to entry’ for hedge accounting.

Yours very truly,

/s Louis Edwards

Louis Edwards,  
Director, Derivative Accounting and Reporting