



76 South Main St.  
Akron, Ohio 44308

**Harvey L. Wagner**  
Vice President, Controller  
and Chief Accounting Officer

330-384-5296  
Fax: 330-384-5299

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International Accounting Standards Board  
30 Cannon Street  
London  
United Kingdom  
EC4M 6XH

Email: [iasb@iasb.com](mailto:iasb@iasb.com)

Re: Comment Letter — *Hedge Accounting*

Dear Board Members:

FirstEnergy Corp. genuinely appreciates the opportunity to provide comments on the International Accounting Standards Board (IASB) exposure draft *Hedge Accounting*.

FirstEnergy is a diversified energy company in the United States with approximately \$48 billion of assets, \$16 billion in annual revenues and \$16 billion in market capitalization. Our subsidiaries and affiliates are involved in the generation, transmission and distribution of electricity, as well as energy management and other energy-related services. Our ten electric utility operating companies comprise the largest investor-owned electric system in the United States, serving 6 million customers within a 65,000 square-mile area in the Midwest and Mid-Atlantic regions of the United States. Our generation subsidiaries control more than 24,000 megawatts of capacity.

Overall, we support the IASB's proposed changes to the general hedge accounting requirements in IAS 39 in order to provide more useful hedge accounting information that reflects an entity's risk management activities and the extent to which those activities are successful in meeting an entity's risk management objectives. We also support the proposed change to a more objective-based approach as a replacement for the more complex, rules-based approach in the existing hedge accounting model.

We offer the following responses to questions set out in the exposure draft that are applicable to our operations.

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 that the objective of hedge accounting should be 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 materially impact earnings, including the context, purpose and extent of the use of hedging instruments.*

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?

*We agree that a non-derivative financial asset or non-derivative financial liability measured at fair value through profit or loss should be eligible for designation as a hedging instrument. We believe the ability to designate a non-derivative financial asset or non-derivative financial liability as a hedging instrument provides an entity with an increased opportunity to manage exposures arising from particular risks. Specifically, the allowance of a non-derivative financial asset or non-derivative financial liability hedge designation provides an entity with the opportunity to appropriately evaluate and potentially employ a risk management strategy aimed at offsetting the changes in the fair value or cash flows of a designated hedged item and will enable an entity to better align risk management practices with hedge accounting.*

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 an aggregated exposure that is a combination of another exposure and a derivative should be permitted designation as a hedged item. An entity's implemented risk management strategy, although intended to mitigate a particular risk, may potentially leave an entity exposed to accounting results that are inconsistent with the results of its economic risk management activities under the existing accounting model, due only to the fact that a derivative is a component of the risk that is being managed. The ability to designate an aggregated exposure that includes a derivative as a hedged item would better align an entity's accounting and financial statement presentation with the economic position and results of its risk management activities. We believe that including an aggregated exposure that is a combination of another exposure and a derivative as a qualifying hedged item is an improvement to hedge accounting that will better reflect risk management activities in financial statements in accordance with the objective of the exposure draft. We encourage the IASB to consider expanding guidance on this topic to specifically address hedge relationship classification (i.e. fair value hedge, cash flow hedge, or hedge of a net investment in a foreign operation).*

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 support an entity's ability 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. We further*

*support the requirement that the risk component is a separately identifiable component of the financial or non-financial item and the changes in the cash flows or fair value of the item attributable to changes in that risk component is reliably measureable. Entities use financial instruments to manage their exposure to various risks such as interest rate risk, price risk, credit risk and foreign exchange risk. These risks may be applicable to the entire item; however, certain circumstances may exist in which a particular component of the hedged item exposes the entity to a particular risk (e.g. a long-term contract with pricing indexed to various factors, one of which is a contractually specified commodity market). The ability of an entity to minimize its exposure to a specific risk, such as market price fluctuations of a specific commodity market, allows an entity to align risk management strategies with hedging opportunities that would achieve other than accidental offset. We believe that the ability to designate a specific risk that is separately identifiable and reliably measureable as a hedged item is an improvement to hedge accounting, as risk management strategies are executed based on a specific risk component.*

**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 support an entity's ability to designate a layer of the nominal amount of an item as the hedged item (e.g., the first 200 megawatt-hours of electricity sales in a particular year). The exact timing and quantities of certain hedged items, such as forecasted transactions, may be indeterminable. The ability to apply a hedging instrument to such an instance gives an entity the opportunity to manage a particular risk, which allows an entity to better align risk management strategies to foreseeable, quantifiable risk exposures.*

*We agree that a layer component of a contract that includes a prepayment option should not be an eligible hedge item in a fair value hedge, if the option's fair value is affected by changes in the hedged risk as a separately identifiable risk component would not be applicable. To comply with the requirements for qualifying fair value hedges, an entity shall remeasure the hedged item for fair value changes. Prepayment options would fail to qualify as an eligible hedged item because remeasurement for fair value changes attributable to the hedged risk would have already been achieved.*

**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?

*We agree that a hedging relationship should meet all of the hedge effectiveness requirements in paragraph 19 of the exposure draft as one of the requirements to qualify for hedge accounting. We believe that an objective-based assessment of hedge effectiveness on a forward-looking basis and the elimination of the 80-125 percent bright line test would enhance the link between hedge accounting and an entity's risk management activities.*

**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 support rebalancing the hedging relationship when the risk management objective remains the same coupled with the hedging relationship continuing to achieve other than accidental offsetting. We recognize and agree that any hedge ineffectiveness associated with rebalancing would trigger immediate recognition within an entity's statement of profit and loss. We further support the revised hedging relationship being accounted for as a continuation of an existing hedge rather than as a discontinuation in such circumstances. We believe that hedge accounting should reflect an entity's risk management strategy for financial statement users. Due to various facts and circumstances, a mismatch between the weightings of the hedged item and the hedging instrument may occur. The objective of the hedge effectiveness assessment is to ensure that the hedging relationship will produce an unbiased result and minimize expected hedge ineffectiveness. Rebalancing may be required to re-align the hedging relationship with risk management policies in view of the changed circumstances. We agree with the IASB's view that these adjustments to the hedged item or hedging instrument do not change the original risk management objective but instead reflect a change in how risk management strategies are executed in consideration of changes in circumstances.*

*We support proactively rebalancing the hedging relationship if an entity expects the hedging relationship to fail the objective of the hedge effectiveness assessment. We believe that allowing an entity to rebalance under such terms would improve the timeliness of adjustments to the hedged item or hedging instrument as well as minimize hedge ineffectiveness.*

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?

*We agree that an entity should discontinue hedge accounting prospectively; however, we do not agree that such discontinuation should only be when the hedging relationship ceases to meet the qualifying criteria of the hedge effectiveness assessment objective. We do not support the position that an entity should be barred from discontinuing hedge accounting for a hedging relationship that continues to meet the risk management objective and strategy and qualifying criteria under which it initially qualified for hedge accounting. Hedge accounting, by its very nature, is elective and therefore, we believe that an entity should reserve the right to discontinue hedge accounting at its discretion. We believe that the ability to dedesignate hedges is critical to risk management strategies as elective dedesignations enable an entity with the ability to rebalance derivative portfolios and optimize portfolio management techniques, which may not be achieved merely applying the guidance in the*

*exposure draft regarding hedging relationship rebalancing as outlined in paragraph 23. We believe the proposed guidance outlined in paragraph 24 would restrict an entity's ability to align accounting with risk management strategies. We encourage the IASB to consider retaining the current model under which an entity may dedesignate a hedging relationship prospectively if it so chooses.*

- 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?

*We agree that the gain or loss associated with fair value hedges should be recognized in other comprehensive income with the ineffective portion of the gain or loss transferred to earnings. We believe that the guidance in the exposure draft would be an improvement to hedge accounting that would reduce accounting complexity, simplify financial reporting and improve comparability. The requirement to record a fair value hedge gain or loss in other comprehensive would align fair value hedge accounting and cash flow hedge accounting, resulting in a single method for hedge accounting. We believe that a single method for hedge accounting would minimize accounting complexities and reduce earnings volatility. We support the IASB's view that such an approach would improve the usefulness of the reported information for users, as all hedging activities would be reflected in other comprehensive income, resulting in greater transparency and comparability. In addition, such reporting yields a single source for reporting the effects of risk management strategies pertaining to hedging instruments.*

*We 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. We believe that such financial statement presentation would eliminate the mixed measurement presentation of hedged items. For example, risk management strategies employed to hedge interest rate risk of long term debt would result in debt being solely reported at amortized cost with the associated hedge on long term debt being reported at fair value. In addition, we agree that the separate line item should be presented within assets for those reporting periods for which the hedged item is an asset and within liabilities for those reporting periods for which the hedged item is a liability. Presenting the fair value of hedging instruments on the face of the statement of financial position would result in greater transparency and improved financial reporting.*

*We are electing not to comment on question 9(c) due to limited applicability or impact to our operations.*

- 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?

*We are electing not to comment on question 10 due to limited applicability or impact to our operations.*

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 support hedging a group of items only if the group consists of items that individually are eligible hedged items, the items in the group are managed together on a group basis for risk management purposes and for cash flow hedge accounting, offsetting cash flows are expected to affect earnings in the same reporting period. The proposed accounting provides an entity with greater flexibility in aligning risk management strategies with 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 agree that a hedge of a group of items with offsetting risk positions that affect different line items in the income statement, any hedging instrument gains or losses recognized in profit or loss should be presented in a separate line from those affected by the hedged items. We believe that such guidance limits the complexity of hedge accounting and limits potential accounting complications associated with grossing-up all affected income statement line items.*

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 proposed disclosure requirements for hedge accounting. We encourage the IASB to consider specifically requiring disclosures pertaining to the methodology used to evaluate hedge assessment as well as the frequency in which such an assessment is performed. We believe that the outlined disclosure requirements will provide investors and creditors with an enhanced understanding of how and why an entity uses hedging instruments, the accounting implications of using hedging instruments and how hedging instruments impact an entity's financial position, other comprehensive income and earnings.*

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 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. We support the IASB's proposal to amend the scope of the current hedge accounting model to allow a commodity contract to be accounted for as a derivative in certain circumstances. However, we encourage the IASB to retain guidance that allows an entity to designate the 'own use' scope exception with the exception being permissible for the purchase or sale of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold by the entity over a reasonable period of time in the normal course of business.*

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?

*We are electing not to comment on question 15 due to limited applicability or impact to our operations.*

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 the IASB's view that the proposed requirements for hedge accounting should be applied prospectively.*

FirstEnergy appreciates the opportunity to comment on the IASB's Exposure Draft. We support the IASB's effort to improve accounting for, and to simplify and improve financial reporting of, hedging activities.

Sincerely,

