

GEFIU Financial Accounting Working Group

GEFIU
GESELLSCHAFT FÜR FINANZWIRTSCHAFT
IN DER UNTERNEHMENSFÜHRUNG E.V.

„Association of Chief Financial Officers Germany“

Sir David Tweedie
Chairman of the
International Accounting Standards Board
30 Cannon Street

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commentletters@iasb.org

March, 9th 2011

Re: Exposure Draft ED/2010/13 – Hedge Accounting
- Comment Letter of the GEFIU Financial Accounting Working Group -

Dear Sir David,

The GEFIU (Gesellschaft für Finanzwirtschaft in der Unternehmensführung e.V.) is the German Association of Financial Officers; it has about 200 members who are chief financial officers or finance directors of German industrial and trading companies as well as insurance companies, banks and other financial services.

The “Financial Accounting Working Group” of GEFIU consists of accounting experts from more than 30 German companies the majority of which are registered at the German Stock Exchange (DAX). On behalf of our Working Group we appreciate the opportunity to comment on your publication of the above exposure draft issued in December 2010. Our comments and answers represent the majority opinion of our working group.

We strongly support the IASB’s intent to align risk management and accounting by proposing a more principle-based approach for hedge accounting. We are of the opinion that the proposed changes are an important step towards a better representation of the business models and risk management strategies of entities in their financial statements. This is in particular true with regard to the following issues:

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- Eligibility of hedged items and hedging instruments, in particular
 - designation of specific risk components in non-financial items,
 - designation of a combination of an exposure and a derivative as a hedged item;
- Groups of items and net positions, i.e. permitting hedge accounting for relationships other than between a single hedging instrument and a single hedged item;
- Effectiveness testing, in particular
 - elimination of retrospective effectiveness testing,
 - elimination of the 80 – 125 %-bright line,
 - strong link between effectiveness testing and risk management; we have, however, concerns regarding the operability of the proposed provisions to mandatorily rebalance existing hedging relationships and thus urge the IASB to deliberate on the suggestion leaving the decision to rebalance solely with preparers in accordance with their risk management without prescribing complex principles to handle this;
- Accounting for the time value of an option that qualifies for hedge accounting; the proposals will help to avoid income volatility that is only accounting-driven, but does not exist economically.

We also welcome the continuation of the IASB's discussions with regard to open portfolios and macro hedges in a later phase of the project, because this would be a further step towards the alignment of hedge accounting and risk management, in particular with regard to dynamic hedging strategies. Nevertheless, we think that the present exposure draft is an important step in improving the presentation of the business models and risk management strategies in the financial statements of the entities so that we strongly support the IASB's intent to issue the new requirements for hedge accounting even without having finished the deliberations on macro hedging if this is not possible in the short term.

In the following, we would like to comment on selected aspects of the exposure draft:

Objective of hedge accounting: As mentioned above, we generally support the IASB's intent to align accounting and risk management. We also agree with the proposal that hedge accounting shall continue to be based on a voluntary designation of hedge relationships and not be mandatory for all risk management activities of an entity. We think that it is not possible to apply hedge accounting to the full range of risk management strategies that exist in practice.

However, we believe that a non-economically justified restriction is still pending in the exposure draft. There are numerous examples where the risk management strategy is to hedge one or more risks attributable to items that do not affect profit or loss, e.g. equity instruments that will (in accordance with IFRS 9) be designated as at fair value through other comprehensive income. Under the current proposals, these instruments would not be eligible for hedge accounting, although they can represent economic hedges. In these cases, it is not possible to represent risk management strategies adequately in the financial statements. We therefore ask the IASB to reconsider this issue so that hedge accounting is not restricted by

a rules-based measure and propose that the eligibility of hedged items should be broadened to items whose value changes go through other comprehensive income only.

Discontinuing hedge accounting: We basically agree that an entity should discontinue hedge accounting when the hedging relationship ceases to meet the qualifying criteria. However, we think that it should be allowed furthermore to discontinue hedge accounting voluntarily; this would also be in line with the optional character of hedge accounting. It is our experience that hedges may become very complex over time, e.g. when they have to be rebalanced regularly. In such a situation, an entity could decide to revoke the designation of the hedge and include the effects in profit or loss from this point in time in order to avoid complex and error-prone accounting. As the voluntary revocation of hedge accounting (when all criteria are still met) does not lead to a reclassification of the OCI components into profit or loss (in the case of cash flow hedges), this is not a driver to generate income effects.

Partial-term hedging: We propose to allow the designation of hedging instruments for only a portion of the time period during which the hedging instrument remains outstanding, provided that the entity can disaggregate the hedging instruments into components reliably (e.g. in case of swaps).

Accounting for fair value hedges: We strongly support the IASB's intent to retain a dedicated accounting treatment for fair value hedges, because we believe that the fundamentals of fair value hedges are quite different from cash flow hedges. Nevertheless, we would like to make the following remarks:

- We believe that the introduction of a two-step approach for fair value hedges does not add any value. There is in our opinion no rationale that supports the recognition of the gain or loss of the hedged items and hedging instruments in other comprehensive income. Furthermore, the immediate reclassification of ineffectiveness from other comprehensive income to profit or loss is in substance not a change compared to IAS 39 which already requires ineffectiveness to be recognised in profit or loss.
- We understand that the proposal intends to avoid a mixed measurement for the hedged item, e.g. an amount that is measured at amortised cost with a partial fair value adjustment. We generally support this approach. However, we would like to ask the IASB to clarify that the separate lines for the gain or loss of the hedged item are not necessarily to be shown on the face of the statement of financial position. This information in itself (i.e. on the face of the balance sheet) is not necessary to understand the risk management policy of an entity since it is redundant with the information provided in the disclosures. On the contrary, in the case of an entity that uses hedge accounting for several asset and liability items, it would lead to a huge number of additional line items which would make the statement of financial position look complex and confusing. Moreover, IAS 1.55 already requires entities to present separate line items on the face of the balance sheet if those are "relevant to an understanding of the entity's financial position". In our opinion, it is therefore not necessary to introduce a special provision for all fair value hedges, because the information is already required by IAS 1 if relevant.

Disclosures: We agree that disclosures play a fundamental role in understanding the risk management policy of an entity. We also support the IASB's intent to require more judgement compared to IAS 39 (cf. ED/2010/13 par. 40-43). To follow this objective, par. 44-52 of ED/2010/13 would rather have been included in the application guidance (and not in the standard itself). This would in our opinion avoid a rule-based interpretation of the requirements as these paragraphs may be understood as a checklist to be followed completely by the entities.

Although we acknowledge the need to disclose the hedging and risk management strategies in general, we strongly oppose to the required disclosures, especially in par. 45-48 concerning "the amount, timing and uncertainty of future cash flows".

This information is proprietary information with a highly prognostic character and disclosure could lead to competitive disadvantage. Disclosing the risk management strategy, with e.g. the applied hedge ratio or the amount of positions hedged (par. 46(a)) could cause other parties to take advantage of the information, in particular it could grant competitors insights into crucial estimates concerning the underlying business. In addition, legal issues could arise on the disclosure of these information.

Therefore we urge the IASB to leave disclosure requirements on a more general level, especially eliminating the need to disclose the amount of the risk exposure being hedged (par. 46(b)) and the monetary amount to which the entity is exposed (par. 46(a)).

We assume that these disclosure requirements could also become a competitive disadvantage to apply such hedging on EU level, if the FASB has less detailed requirements.

In general, we would like to ask the IASB to review the existing and proposed disclosure requirements for financial instruments to ensure that there is a reasonable cost-benefit trade-off. It has to be noted that extensive disclosure requirements would necessitate a significant extension of the chart of accounts for group reporting purposes, possibly changes of IT systems, the adaptation of interfaces etc.

Amendment of own use exemption: We generally welcome the IASB's efforts to align accounting and risk management also with regard to the own use exemption. We are, however, concerned that the proposal does not really help to address practical problems in this area for the following reasons:

For us it is not clear whether the IASB intends to introduce an obligation to fair value commodity contracts if the preconditions mentioned in the exposure draft are fulfilled or if this shall be optional. In our opinion, it is absolutely necessary to leave derivative accounting as an option since automatic application of fair value accounting for contracts managed at fair value would lead to an accounting mismatch and resulting income volatility in some situations. This is especially occurring when contracts are managed together with assets that are not in the scope of IAS 39 (e.g. power plants and related electricity supply contracts).

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Credit/inflation risk: We believe that prohibiting hedge accounting for credit risks is a rule-based measure that does not fit to the objectives followed by the IASB. Rather, we would propose that hedge accounting should be applied if all criteria are otherwise met (i.e. eligibility of hedged item, consistency with risk management etc.). The same would in our opinion be true for inflation which according to ED/2010/13 par. B18 shall be excluded from hedge accounting as well.

If you have any questions or remarks please do not hesitate to contact us:

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We would be happy to discuss any of our comments at your convenience.

Yours sincerely,

/s/ Dr. Bernd Haeger

Chairman of the

“GEFIU Financial Accounting

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/s/ Dr. Britta Leippe

Member of the

“GEFIU Financial Accounting

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