

## Appendix 1

### 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?*

Far agrees with the proposed objective of making the hedge accounting reflect the actual management activities taking place in practice. This will enable users to get information from the financial report which better explains the hedging activities undertaken.

Far has however noted that the restriction of hedge accounting to activities affecting profit or loss retains one aspect of the current gap between risk management activities and hedge accounting. Limiting hedge accounting to items that affect profit or loss will not make it possible to reflect some valid risk management activities. The proposed standard will thus not fully reach the objective of reflecting the risk management activities of the entity. Strategies that may not be eligible for hedge accounting include for example;

- The economic risks arising from instruments classified as equity, according to IAS32, when the risks are similar to those arising from instruments classified as liabilities.
- Strategic investments in equity securities (classified as at fair value through OCI) may at some point in time be divested. Being able to hedge the fair value risk in such investments therefore is a valid risk management objective, once the decision to divest has been made, Furthermore the strategic investment may be exposed to foreign currency risk.
- Actuarial gains and losses for post retirement benefits are exposed to, for example, interest rate risk and mortality risks. It may be economically rational for entities to want to hedge these risks which affect total comprehensive income over a significant period of time.
- Share based payments are hedged by total return swaps or similar.

Far proposes that the objective of hedge accounting is extended to also include items affecting other comprehensive income or equity. Far believes that for exposures not affecting profit or loss it may be appropriate to let the fair value changes of the hedging instrument to be posted to other comprehensive income and not recycled if the hedged item will not affect profit or loss. Ineffectiveness from overhedging i.e. when the fair value changes of the derivative exceed the fair value of the hedged item should be transferred to profit or loss.

### 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?*

Far agrees that non-derivative assets and liabilities measured at fair value through profit or loss should be eligible hedging instruments. There seems to be no conceptual reason to preclude an instrument measured at fair value through profit or loss from being designated as a hedging instrument when this is consistent with an entity's risk management.

Far also believes that there are circumstances when the Board should consider permitting an entity to designate a risk component of a derivative (or other financial instrument) as a hedging instrument when that risk component is separately identifiable and reliably measurable. These situations may for example be when a cross-currency interest rate swap (CCIRS) is used to hedge both FX risk and interest rate risk. It is clear from IAS 39.IG.F.2.18 that a CCIRS can be split into two components and be used to hedge two hedging relationship as long as the entire instrument is designated. In many cases there is a natural offset for the FX risk without having to apply hedge accounting. Far therefore believes it may be appropriate to allow separating parts of the derivative as long as that part affects the profit or loss, and that it is consistent with the entity's risk management strategy. Far believes that the preservation of the current rule in IAS 39 to only allow to separate the interest element of FX forwards, or the time value of options may be inconsistent with the objective of hedge accounting as stated in the ED and all aspects of the prohibition has not been considered. For example it is not clear why the restriction is needed.

In addition, Far believes that the Board should clarify the prohibition on designating a hedging instrument for only part of its life, and reconsider why a synthetic collar, (a combination of a purchased and a written option) cannot be used as a hedging instrument if it is a net purchased option.

### 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?*

Far agrees with the suggestion of allowing an aggregated exposure that is a combination of another exposure and a derivative as an eligible hedge item. Allowing entities to hedge aggregated exposures enables entities to reflect the common practise of managing risks separately.

### 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 measurable? Why or why not? If not, what changes do you recommend and why?*

Yes, Far believes that the ability to hedge risk components also for non-financial hedged items is one of the most important changes in the ED. Hedging risk components is especially important for companies with significant commodity risks. Far supports a principles based approach and agrees that "separately identifiable and measurable" is the correct principle. In the case of contractually specified risk components it is clear that hedge accounting should be allowed.

Far believes that hedging of non-contractually specified risk components should also be allowed. The reference to the market structure however is not particularly clear but Far agrees that the market structure has a role in determining in what situations a risk component is separately identifiable and measurable which requires judgement. We believe, however, that the guidance on when a component is "implicit in the fair value or cash flows of an item" needs to be clarified. This could for example be done by focusing at components a market participant would typically consider an essential factor to arrive at the price/fair value of the

entire item. Unless the component is thus relevant for market participants in pricing the entire item, it should not be eligible for hedge accounting on a component basis.

The provided examples are not helpful in illustrating the principle of a separately identified component.

In the B15 (b) the Board exemplifies components using jet fuel. It is not clear to Far why this is an example of hedging components rather than a proxy hedge. Hedging a risk component normally implies that the hedged component of the entire item can be measured using a hypothetical derivative that exactly reflects all quality, timing, location and other characteristics of the hedged item and the actual derivative used has the same quality, location and other characteristics as the hedged item. Timing and credit risk may be different and cause ineffectiveness.

Proxy hedging on the other hand implies that the hedged item (the entire item or risk component) is different in some respect – it could be the differences in the actual commodity, quality, location or other factors where the hedged item and the hedging instrument will not be identical and therefore cause ineffectiveness. While Far agrees that jet fuel is refined from crude oil and/or gas oil it is not clear why there is anything more than a correlation between crude oil and jet fuel prices. Is the cracking spread anything but the difference between the price of crude oil and jet fuel prices? If the link between crude oil and jet fuel is simply based on correlation (and not based on the view that crude oil is a component of jet fuel) Far believes that ineffectiveness should be reported. If crude oil is really a component the reason for this must be explained in the example.

Making this distinction clear is necessary to achieve consistency in practise. Far believes that in general it will not be in line with generally accepted risk management principles to hedge risk components unless they are separately identifiable and measurable. Far believes the linkage between risk management practises and determining what is a component eligible for hedge accounting is essential to meet the objective that the accounting should reflect the risk management activities undertaken.

*Cash flows that are less than the cash flows of the entire item*

Far disagrees with the restriction that a hedged component must have cash flows that are less than the cash flows of the entire hedged financial asset or liability. Far questions the conceptual basis why this restriction is applicable only to financial hedged items. Far is furthermore concerned that if it is applied also to non-financial items a number of relevant hedging strategies could not achieve hedge accounting on a component basis.

Far does not disagree that in the circumstances of the example that illustrates the Sub-libor issue the accounting outcome is not intuitive or appropriate. Far notes however that the examples are built on an unusual fact pattern where the negative spread is actually larger than the benchmark rate. This would imply that there has been a shift in the market structure that was not anticipated by the parties to the contract. Far believes that the requirements on “achieving other than accidental offset” would probably prevent hedge accounting in circumstances where the counter-intuitive outcome would be potentially be applicable.

When measuring ineffectiveness it may be argued that accepting the hedge risk as being cash flow larger than the actual cash flows is equivalent to measuring the fair value change of cash

flows that does not exist. On the other hand, if an entity is hedging the “risk free” rate basing the measurement on cash flows less a negative credit spread the cash flows are inconsistent with the hedged risk. The proposed solution in B26 is a work-around that will largely achieve the same outcome as designating the Libor risk of the entire instrument. In most situations the additional ineffectiveness reported will be insignificant. On balance Far therefore believes that the restriction is thus not needed.

#### **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?*

Far agrees since this is consistent with normal risk management activities.

*b) Do you agree that a layer component of a contract that includes a prepayment option should 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?*

Due to the fact that not all prepayment options have the same effect on the fair value of the hedged risk, it is not obvious that a layer component (as described above) should not be eligible as a hedged item. There are other factors apart from the fair value risk that may trigger the exercise of prepayment options, particularly in the case of mortgages. Far believes that this question is closely linked with the macro hedging project and designating a layer shouldn't be precluded until the macro hedging project has concluded on the issue for macro hedging purposes.

#### **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?*

Far agrees that removing the existing qualification criteria that a hedging relationship has to have an effectiveness of 80–125 % is a major improvement to hedge accounting. The current distinction between hedges that achieve hedge accounting and those that do not, even though they are economically hedging an item, does not result in useful information in the financial statement.

Far believes that hedge accounting that is aligned with the risk management activities results in better and more useful financial information. The proposed effectiveness criteria reduces the complexity for many entities with plain vanilla strategies especially for foreign currency and interest rate hedging since qualitative assessments would be sufficient in many cases. Far is nevertheless concerned that the hedge effectiveness requirement to meet the “objective of the hedge effectiveness assessment” will increase rather than decrease the complexity of achieving hedge accounting for more complex strategies or where there exist a basis risk. This may prevent the board from achieving the stated objective of the new ED i.e. to represent in the financial statement the effects of their risk management activities.

The qualification criteria “the objective of the hedge effectiveness assessment” require that the results of the hedge should be unbiased. This requirement, however, is not further defined and therefore the meaning of it is unclear and may need to be clarified.

The second aspect of the criteria, minimising hedge ineffectiveness, may cause designations for hedge accounting purposes to be different than the designation for risk management purposes. Far agrees that from a strictly economical perspective an entity would normally pursue the hedge ratio that is economically the most rational hedging ratio but Far does not believe this should be mandated in an accounting standard. An entity may choose a non-optimal hedging ratio because it may be operationally simpler to monitor and more intuitive to explain hedging relationships using a hedging ratio of 1 to 1 even though a different hedge ratio would result in less ineffectiveness. In the light of the fact that the current IAS 39 does not require an entity to designate a hedge relationship using a ratio other than 1 to 1 and the fact that some risk management strategies use a 1 to 1 hedge ratio although over time there is a tendency towards over- or under hedging (still being within 0,8-1,25) it appears inconsistent with the overall objective to portray the effect to the entities risk management activities in the financial statements to mandate other hedge ratios than those used for risk management purposes. Other reasons why a non-optimal hedging ratio is chosen may include that the entity already has the derivative or that only standardised contracts are used on the derivatives market in question making entering into non-standard volumes less cost-effective.

The complexity of determining the optimal hedging ratio at inception and then continuously monitor and rebalance the hedge may actually be more restrictive for hedges with a basis risk than the 80–125 % threshold was. As one of the objectives of the project was to enable hedge accounting for economically defensible strategies that could not achieve hedge accounting under IAS 39, the “objective of the hedge effectiveness assessment” may cause the ED to fail in this perspective.

Far believes the “objective of hedge effectiveness assessment” criteria may to some extent be driven by anti-abuse considerations. This could for example be designating the hedged item to achieve a particular accounting effect such as avoiding over hedging. Far believes that such designation would not be in accordance with general risk management practise and discipline would be achieved by the requirement to disclose the objectives and strategies of the hedges for which hedge accounting is applied. Thus, the anti-abuse effect can be achieved without actually forcing the complexity of unbiased requirement on the preparers. The risk for abusive designation could be limited by retaining the guidance in IAS 39.AG 107A where designating a nominal amount of the hedged item as anything different than matching the derivative can only be done if that designation reduces ineffectiveness. Far believes that the situations where a one-to-one designation could be used to “hide” a speculative strategy may exist but are very limited and that, on balance, the complexity that arises from requiring the optimal ratio for all preparers is not motivated by the potential cases where the designation could be abusive.

Far suggests that the Board considers whether the objective for hedge effectiveness assessment is necessary or if it could be removed from the qualification criteria and be replaced by the guidance on designation that is in IAS 39.AG 107A. The qualifying criteria would then include four parts;

1. Only eligible hedged items and eligible hedging instruments can be included
2. At the inception of the hedging relationship documentation shall be prepared linking the hedge to a risk management strategy. (which should, be disclosed in the financial statements if material,)
3. The hedge achieves other than accidental offset, and

4. is designated in accordance with IAS 39.AG107A

### 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?*

Far believes that the objective of effectiveness assessment should be removed as a qualifying criterion, see under question 6 above.

Requiring entities to continuously monitor the optimal hedge ratio requires significant efforts and is complex. The increase in the usefulness of the financial statement is limited as the requirement would also result in disconnecting the hedge ratio used for hedge accounting purposes from the one used for risk management purposes. This is inconsistent with the purpose of the project on hedge accounting. However, Far believes that if it is the entity's hedging strategy to determine the optimal hedge ratio and maintain that optimal hedge ratio rebalancing would be undertaken regardless of the standard requiring it or not. A requirement to rebalance for accounting purposes unless it is also done for economical purposes will only result in relabeling the actual ineffectiveness of the hedge as trading results instead of as hedge ineffectiveness. Far does not believe this is an appropriate reflection of the effects of the actual hedging strategy undertaken.

*b) Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of a 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?*

Yes, if it is a part of an entity's risk management strategy to proactively rebalance hedge relationships this should be seen as rebalancing and not de-designation and re-designation also for hedge accounting purposes since this portrays the effect of the risk management activities in the financial statements. The rebalancing concept is useful for dynamic strategies. Far believes that when an entity is continuously monitoring the hedged item and hedging instruments to adjust it for changes in the actual exposure the concept of rebalancing is better than the current practise de-designation and re-designation to reflect the dynamic nature of the hedging relationship and would thus be useful if it is expanded to other situations than when the optimal hedging ratio because basis risk changes.

Far also believes that the ability to dynamically adjust the hedging relationship is a necessary component for achieving a useful macro-hedging model and Far believes it should be explored further.

### 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?*

As stated in question 6, Far does not believe that meeting the "objective of the hedge effectiveness assessment" is useful as criteria for qualifying for hedge accounting. Consequently Far does not believe that failing to meet this criterion should trigger discontinuation of hedge accounting unless risk management decides to discontinue the



hedge. However as Far believes that the “other than accidental offset” is a necessary criteria to qualify for hedge accounting, there will be situations for example when the counterparty of the hedging instrument is experiencing financial difficulties and entities applying hedge accounting no longer can argue that the derivative is effective in achieving other than accidental offset. Hence, Far agrees with the proposal of discontinuing hedge accounting prospectively when qualifying criteria of accidental offsetting no longer is met.

*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 criteria? Why or why not? If not, what changes do you recommend and why?*

The ED states that if the objective for the hedge relation is no longer pursued the hedge should be discontinued. This implies that the objective can be determined on the level of an individual hedge. It is not uncommon for entities to consider the objective of hedging to be at an entity level rather than an objective for each individual hedge. Far believes the level of objective for a hedging relationship needs to be clarified.

- If the Board intends the objective of the hedge relationship to be determined at the level of the individual hedging relationship Far believes that the board is actually not changing anything in relation to the current rules. In this situation the objective to hedge the net investment of one subsidiary in EUR could be changed while the entity maintains the strategy for another EUR denominated subsidiary. If this is the case Far would prefer the standard to state that de-designation is still allowable rather than saying it's prohibited but you can change the objective if you want to stop hedge accounting.
- If the Board does not intend the objective of the hedge relationship to be at the level of the individual hedge then Far does not agree with the proposal. In this situation the objective could be to hedge the net investments of subsidiaries whose functional currency is EUR. In order to stop hedge accounting for one entity hedge accounting would need to be stopped for all as the hedge accounting objective would need to be changed and thus affect all EUR net investment hedges. Prohibiting discontinuation of hedge accounting in this situation has serious implications for some strategies (see next paragraph). Since the choice of applying hedge accounting is voluntary Far believes that it should also be voluntary to discontinue it. Far notes that prohibition can be avoided by closing the derivative and simply replace it with another derivative.

One consequence of the prohibition is that it introduces complexity for some commonly used strategies, For example; it is common for entities to hedge cash flows from forecast sales in foreign currency using a derivative to match the payment date. When the sales occur it is common practise to discontinue the hedge in the accounting. A natural offset will be achieved when the forecast sale has been recognised in the profit and loss and hedge accounting will no longer be needed. Far believes that these activities should not be prohibited and therefore disagree with the proposal.

Far agrees that some entities may frequently designate and de-designate hedging relationships. Far does not believe this to be abusive as in many cases it is a consequence of the misalignment between accounting and risk management practises. For example in situations where according to the risk management strategies an entity wants to hedge the risk of an exposure for which it is difficult or even impossible to achieve hedge accounting because of the detailed rules in IAS 39. In these situations it is sometimes possible to identify another

eligible hedge item to use (proxy designation). A better alignment between hedge accounting and risk management activities may thus reduce the frequency of de-designations and re-designations.

In any dynamic hedging strategy including fair value portfolio hedging of interest rate risk de-designation is an essential tool. Far therefore believes that this question should be addressed as part of the considerations on macro hedging.

### 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?*

Far does not agree with the proposed presentation in other comprehensive income of the effects of a fair value hedge and believes that retaining the presentation requirements from IAS 39 today is preferable to the proposed presentation in the ED.

The ED proposes three additional line items in other comprehensive income to present the effects of a fair value hedge in addition to the effects in profit or loss. Far believes it would be more useful to present the gross numbers effects of fair value hedges in the disclosures rather than on the face of the financial statements. Presenting the gross numbers on the face of Other Comprehensive Income where the ineffectiveness is removed from OCI and moved to profit and loss would not add value to the users in proportion to the complexity added for the preparers. Far does not disagree with the fact that users may well want to understand the fair value changes of the hedge instrument and hedged item and the ineffectiveness portions, however, Far believes it is more useful presented in the disclosures rather than on the face of OCI.

*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?*

Far agrees that there would be benefits of disclosing the “pure” amortised cost and the fair value adjustment of the hedged item separately. This would give a more clear understanding of the effects of fair value hedging since the information content of the amortised cost measurement is retained.

Far believes, however, that these disclosures should be notes rather than on the face of the balance sheet and thereby retaining the unit of account on the face of the statement of the balance sheet. There would be two reasons for this form of presentation. The first is because splitting a hedged asset or liability is inconsistent with the unit of account which would be financial instrument as a whole. The second reason would be that a split would increase the number of item lines significantly, especially in the statements for banks. This will make the understanding of the accounts more complex. Far believes it is sufficient to disclose the fair value adjustments and the amortised cost amounts in notes to the financial statements.

*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?*



Far is of the opinion that this question is not specific to fair value hedge accounting. Far believes any proposal on linked presentation should be addressed with a broader perspective: Issues such as derecognition, pension accounting and subleasing etc should also be considered when determining if a linked presentation requirement would be useful. Far therefore proposes for the issue of linked presentation to be considered within the project for financial statement or the project for conceptual framework.

#### Question 10

*a) Do you agree that for transactions 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 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?*

Far agrees that the time value of an option is a cost connected to the hedge and therefore should be part of the hedge accounting. Far agrees with the proposal to accumulate the time value of options in OCI. The premium paid for the time value of options used as hedging instrument is a cost for fixating the price of a transaction and should therefore be treated as an acquisition cost and be a part of the value of the acquired asset or the cost of sales. This would also equalise the use of options with swaps, forwards and futures to achieve a reasonable accounting outcome.

Far believes complexity can be reduced however by in exchanging the rule describing two different methods with a principle; for example “the cost should affect profit and loss consistent with the protection bought” alternatively “the cost should affect profit and loss in a manner consistent with the risk management strategy for the hedged item”. Entities will follow their risk management strategy when using options as a hedging instrument. This would also simplify the distinction between transaction related and time period related transactions and making them less important. The models proposed in the ED can be used as illustrative examples of how the principle can be applied.

As the initial time value is a cost of the hedge Far agrees that the cost of the hedge should be allowed to adjust the cost of a hedged non-financial item. Far does not however believe that reclassifying directly from equity instead of recycling through OCI is appropriate. Far believes that when hedging the purchase of a non-financial item the effect of hedge accounting for forward/futures contracts as well as for options, i.e. both the effect of the intrinsic value and the initial time value, should be recycled through OCI. Reclassification directly from equity introduces a new class of transactions in the statement of changes in equity that is not a transaction with owner. Far does not believe that users are misled as long as the recycling through OCI to the carrying amount of a non-financial item is disclosed in the notes.

*b) Do you agree that for a 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?*

Please see under 10(a). Far agrees that the transfer from OCI to the profit and loss should be on a rational basis as described in the proposed method.

*c) Do you agree that the accounting for 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?*

Even though Far conceptually agrees with proposal we note that the proposal introduces significant complexity if the option used for hedge accounting is not “the perfect hedging instrument”. Far agrees that ineffectiveness will exist when using option where the critical terms do not perfectly match the hedged item and that using the perfect derivative will show this ineffectiveness in profit or loss. Far does not however believe that introducing the additional term “aligned time value” is improving the understanding of the accounting requirements. It would be better to refer to the time value of a “hypothetical derivative” since this is a term already used in the ED.

### **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?*

Far believes that the matter of hedging of groups that includes offsetting positions (net hedging) is important and welcome it being addressed in the standard. One very common practice today in risk management strategies is to aggregate the exposure of a group of items for the purpose of assessing the proper amount to hedge and also to be able to reduce the number of derivatives entered into. As for the designation of a group of items to include a net position, Far agrees with the criteria that to be eligible for hedge accounting all items in the group should individually be eligible hedged items as well as being managed on a group basis. The identified hedged item should be the overall group of items that make up the net position.

Far disagrees with the criteria that the cash flows from the hedged items in a cash flow hedge must affect the profit and loss in the same interim period. This will decrease comparability over time and between entities and in many cases make achieving hedge accounting for hedges of net positions is difficult if not impossible. For example in the case of hedging purchase of inventory the possibility of achieving hedge accounting would be dependent on whether or not the hedged purchased piece of inventory can be sold again during the reporting period or not. This will create differences among entities depending on their different inventory turnover and length of reporting periods. The distinction does not increase the usefulness of the financial statements in explaining the risk management strategies applied.

Complexity would also arise within an entity as a strategy may be eligible for hedge accounting in some circumstances and not in another. Two transactions will be eligible for hedge accounting if they occur 90 days apart as long as they are within the same interim period. If the first transactions occur on the last day of a reporting period and the next transaction the next day they will not be eligible for hedge accounting. The proposed criteria for cash flow hedges and groups of items is not aligned with common risk management practices and therefore counteract the purpose of allowing hedges for net positions. The ability to achieve hedge accounting will thus depend solely on the arbitrary timing of transaction. The proposal as it is in the ED is thus a rule and not principle-based. This is contradictory to the main objective of aligning hedge accounting with risk management strategies.

Removing the restriction that the transactions need to occur in the same period to be eligible would however require guidance on how to account when one of the offsetting hedged items is no longer expected to occur.

## 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 (e.g. in a net position), 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?*

Far disagrees with the proposed presentation requirements as we believe this will only create more complexity and not accurately reflect the risk management strategies.

It is not consistent with the objective of aligning hedge accounting with risk management strategies to present net hedging differently than hedging of gross positions. It does not matter for risk management purpose if the hedge is achieved through fair value of the hedging instrument or another hedged item.

Far notes that the exposure draft will make it possible to present the same economic relationship in at least three different ways;

1. If the entity economically hedges on gross basis (i.e., has offsetting derivatives to hedge offsetting gross positions) a gross presentation can be used, i.e. all hedged items are reported at the hedged rate
2. If it hedges are economically made on a net basis there will be a choice of designating either
  - a. a part of a gross position – where only a portion of a gross position will be reported at the hedged rate and the rest of the hedged items will be reported at the transaction rate, or
  - b. designating the net position - where the effects of the derivative will be reported on a separate line item.

Far does not believe that the latter alternative will help users to understand risk management activities. Far believes that in cases where an entity hedges net positions as well as hedges single transactions or groups of gross items, the proposal for separate presentation when hedging a net position will be misleading as it will give the impression that this is the full extent of the hedging activities undertaken. Furthermore for users the impact of a single line item will be difficult to interpret as some hedged transactions will be reported at the hedged rate and others at the transaction rate. Far is not confident that such an inconsistent reporting of the effects of hedging activities in the profit or loss will present the user with more useful information.

Many entities whose risk management strategy is to consider all the items of the group to be the hedged items believe that all items in the group should be reported at the hedged rate (both revenue and costs). Allowing entities to apply gross presentation would be more consistent with the objective of aligning hedge accounting with risk management activities.

### Question 13

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

Far agrees that disclosure is an essential part in improving the usefulness of the financial statements when hedge accounting is applied. No doubt a user will generally benefit from more information rather than less. However, Far feels that the proposal in the ED requires too much details and the burden for the preparers to assemble the information is not proportional to the needs of the users. Specifically this applies to the requirements in p.46.

The requirements in p.46 that an entity need to provide information of the total exposure relating to a risk that the entity has decided to hedge to some extent is problematic. First it is not clear how “total exposure” is defined. When hedging for example the FX risk of firm commitment sales transactions does the total exposure include also expected forecast sales transactions? If it also includes forecasted transactions is there a high probability threshold for providing the information about the exposure? Since this varies between entities the information will be less useful for the users anyhow.

The second issue with requiring information on total exposure and how much of that exposure is actually hedged and at what rate, is that it may be commercially sensitive. It will put entities that have decided to apply hedge accounting at a disadvantage compared to entities that do not apply hedge accounting, as the latter would not have to provide information on total exposure. Sufficient and useful information would be nominal amounts, effects and rights on existing hedging strategies for subsequent periods as that allows users to assess the impact of the derivatives used

Another uncertainty in the p.46 is the meaning of the expression “each subsequent period”; is it related to every reporting period or every year end or will it be possible to aggregate information? Our opinion is that it would probably reduce the burden for the preparers to allow aggregated information as well as it would most likely enhance the usefulness for the users.

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

The current version of IFRS 7 does not require any disclosures for non-financial price risks (such as commodity risks) if they are not hedged. It would be useful to users of financial statements if also non-financial price risk would be mandatory to describe in line with IFRS 7.31 and not limited to those non-financial price risks that an entity has chosen to hedge.

### 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?*

Far agrees with the proposal above since we believe this will allow some entities to better reflect their risk management strategies in the financial statements. The proposal is based on the own-use exception in IAS 39 which is only available if the entity’s sales and purchase contracts will qualify as derivatives (i.e. that the contracts can be settled net in cash or be

readily convertible to cash). If there is more than insignificant transformation the sales contracts may either not be net settled or may not be readily convertible to cash and would therefore not benefit from the proposed changes. For these entities it would be necessary to be able to use the fair value option on non-financial contracts and to inventory if that accounting “is in accordance with the entity’s underlying business model and how the contracts are managed” in order for them to be able to properly reflect the underlying risk management activities. Also in situations when the purchase and/or sales contracts would be eligible to be measured at fair value according to the ED, there are risk management models that include inventory as a forth component of the hedging strategy which is internally monitored at fair value and where the fair value option for the inventory would be necessary in order for these entity to reflect their risk management activities in a consistent manner.

Even though this exposure draft is primarily about hedge accounting Far notes that the issue of the scope of the standard for financial instruments includes the contracts that may qualify as derivative as they are able to be net settled or are readily convertible to cash unless the own-use exemption is used. Far notes that the issue of scope is not addressed in any of the three main phases in the project to replace IAS 39. Over time the paragraphs on the own-use exemption has proven difficult to apply primarily for entities that get caught by net settling a contract even though the entity normally takes delivery of the commodity. Neither IAS 39 nor the ED offers any way to get out of the financial instrument accounting. This issue has not been raised earlier in the process of replacing IAS39 and is not a hedging matter but Far urges the Board to address the question of scope and the own-use exemption as soon as possible as an amendment once hedging and impairment has been finalised.

Far notes however that the proposal would not be applicable for that many entities that do manage commodity risk on a fair value basis.

### **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?*

Far does not believe the three proposed alternatives are viable. Using an adjusted fair value option as alternative for hedging credit risk does not really address the issue of hedging credit risk as a component. Far disagrees with the Board’s view that credit risk is impossible to measure. Far agrees there are still challenges in separating a pure credit risk from the fair value of a fixed rate instrument but we do not agree that it is necessary to have the perfect measurement to be allowed to have hedge accounting. Far notes that some of the differences identified by the board in the basis for conclusion to the ED are equally applicable to hedges of “risk free” interest rate which do accept today, such as differences in liquidity between the markets. Other structural differences such as the “cheapest to deliver” attribute of some CDS may change as markets develop.

Far agrees that measuring the hedged item using a CDS may not be appropriate as we understand there are differences between the CDS market and bond markets that make arbitrage possible. Far does not however believe it is necessary to define credit risk perfectly. IFRS 7 and the fair value option for liabilities of IFRS 9 accepts using for accounting purposes the entire spread over the risk free rate as a proxy for credit risk or another measure that better reflects the credit risk of the entity. Far believes that hedge accounting for credit risk could use the same “proxy” as these other two standards.

*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?*

See response to question 15(a)

**Question 16**

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

In general, Far agrees with the proposed transition requirements as hedge accounting cannot be applied retrospectively it is reasonable not to require restatement of the comparative information. Far does not, however, agree with restricting entities from restating comparative information. Since it is required to apply IFRS9 retrospectively for classification of financial assets and liabilities it would be inconsistent not to allow retrospective application of hedge accounting as well. Far believes that in some situations entities may want to hedge financial instruments that under IFRS 9 are amortised cost but under IAS39 are at fair value through profit or loss. Conversely, it would be inappropriate to maintain fair value hedge adjustments to a hedged item that was at amortised cost under IAS 39 but at fair value through profit or loss under IFRS 9. To be in compliance with earlier phases of IFRS9 Far therefore proposes that it should be elective to apply hedge accounting for the comparative period if the appropriate hedge documentation has been prepared before the start of the comparative time period and a “double set of accounts” have been maintained during the year.

Far agrees that early application should be permitted. Far also believes that early application for the hedging phase should be allowed even though the other phases of IFRS 9 has not yet been applied as long as the accounting for the hedged item will not change due to the other phases of IFRS 9

The effective date, however, may need to be considered in relation to other projects.