

Sir David Tweedie
Chairman
International Accounting Standards Board
1st Floor
30 Cannon Street
London
EC4M 6XH
Dear Sir,

Comment letter on IASB Exposure Draft ED/2010/13 *Hedge Accounting*

On behalf of AarhusKarlshamn AB (AAK) we appreciate the opportunity to respond to the Exposure Draft ED/2010/13 Hedge Accounting (the ED or the proposals), issued by the International Accounting Standards Board (IASB).

Overall we believe that the proposals in the ED provide a number of significant improvements in aligning the accounting more closely with entities risk management strategies. While we agree with the direction of the proposed objective to reflect the entity's risk management activities in the financial statements, we do not believe that the ED provides the necessary changes for reflecting the risk management of so called Commodity Processors in the financial statements.

We have taken the opportunity to comment on those aspects of the ED which is critical for reflecting Commodity Processors' risk management strategy in their financial statements. We have therefore limited our response to the following questions 1, 4 and 14. Our key concerns are noted below and expanded on in the appendix to this letter.

Presenting Commodity Processors' business model and risk management strategy in the financial statements

AAK's primary operations is vegetable oil processing. Thus, AAK purchases vegetable raw materials from around the globe and transforms these raw materials into refined oils and fats. This business model is therefore identical to that of a so called Commodity Processor as described in the IASB's agenda papers for the 18th of October 2010 meeting.

When entering into sales contracts the pricing of the products is based on the current raw material prices with a margin representing processing costs and profit.

The objective of the risk management strategy is therefore to manage the risk exposure to raw material prices and foreign currency risks using a fair value-based risk management strategy and thereby keeping the Group's daily net open position within certain specified limits resulting a close to zero position. The acceptable risk positions / limits are specified in AAK's risk management policy.

In order to manage AAK's risk exposures the treasury department compiles a net position of each type of risk exposures on a real time basis. The net position comprises sales contracts, purchase contracts, inventory, forward contracts and future contracts. It should be noted that management reporting is based on fair value measurement.

The consequence of this risk management strategy is that AAK profits from the processing margin; rather than the fluctuations in the raw material prices or foreign currency exchange rates.

In order to reflect the profits generated by AAK's business model and its risk management strategy Management receives an internal reporting in which inventory, sales contracts, purchase contracts, forward contracts and future contracts have been measured at fair value.

Due to the current restrictions in IAS 39 AAK has previously chosen not to apply hedge accounting due to the complexity and costs involved. Consequently, the result of AAK's business model and risk management strategy has previously not been appropriately reflected in the financial statements. Historically, AAK has therefore provided additional information in order to explain the difference between the "accounting" profit or loss according to IAS 39 and the profit or loss which reflects AAK's business model so that the financial statements provided decision useful information. The difference between the "accounting" profit or loss and the internal reporting has been defined as the so called "IAS 39-effect". However, during 2008 AAK experienced a huge "IAS39-effect" in its financial statements (reversed in the financial statements for 2009). Even more importantly recognising that it likely that the commodity and foreign currency markets will be more volatile in the future, AAK decided to invest the significant resources to implement fair value hedge accounting irrespective of the requirements being inconsistent with AAK's underlying risk management approach.

The reason why the hedge accounting requirements are inconsistent with AAK's risk management approach is that the application of hedge accounting under the current requirements:

- requires tracking exposures on a transaction level whereas AAK's risk management system and processes are based on positions in types of risk exposures.
- requires the application of closed portfolios whereas the entire basis of managing AAK's business model according to its risk management strategy is an open portfolio approach.

Thus, the use of hedge accounting is very strenuous and expensive in terms of needed resources comprising both systems and manpower.

We therefore strongly support an accounting treatment which is consistent with a fair-value-based risk management strategy used by Commodity Processors. However, while the proposal to amend the so called own-use exemption is a step in the right direction, it does not entirely solve the inconsistency between the accounting requirements and a fair-value-based risk management strategy. We therefore suggest to the IASB that it:

- amends the requirements in IAS 2 *Inventory* and thus, allows that inventory is measured at fair value, if it is managed according to a fair value based risk management strategy. (Please refer to our response on question 14 for further details)
- clarifies that sales and purchase contracts should be measured at fair value irrespective of settlement method, if they are managed according to a fair-value-based risk management strategy. (Please refer to our response to question 14 for further details)
- allows the application of an open portfolio approach (i.e., macro hedge accounting) when applying hedge accounting to non-financial items. (Please refer to our response on question 1 for further details)

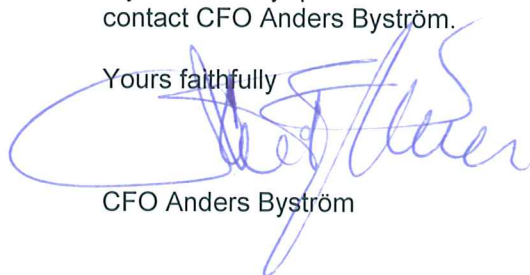
We note that a different timing between an amendment of IAS 2 and the implementation of IFRS 9 would result in undue costs in regards to performing hedge accounting of inventories. We therefore suggest that the amendments to IAS 2 be made as a consequential amendment as part of the IFRS 9 project.

We believe that the above accounting treatment would not only better reflect the business model and risk management strategy of Commodity Processors, but would also significantly reduce complexity.

Closing

If you have any questions about our comments or wish to discuss any of these matters further, please contact CFO Anders Byström.

Yours faithfully



CFO Anders Byström

Appendix

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?

Alignment with risk management activities

We agree with the direction of the proposed objective to reflect an entity's risk management activities in the financial statements. We believe that this objective enhance a more transparent and appropriate presentation of the extent and impact of the hedging activities on the economic performance of the entity. While we agree that the application of hedge accounting should be disciplined, we note that risk management is a dynamic process. Therefore, we are concerned that the requirements in the ED are too restrictive and hence, inconsistent with the manner in which entities often manage their risk exposures. For example, we believe that entities may have difficulties aligning hedging relationships at the transaction level with their risk management strategy. The reason for this is that non-financial entities often monitor and manage their risk exposures on a risk position level rather than on a transaction level. We therefore suggest to the IASB that an open portfolio approach is allowed for non-financial items. We have expanded our comments on this aspect in the following section.

Application of an open portfolio based risk management strategy

The current ED does not address the application of open portfolios for non-financial items. In addition, we note that the IASB is not currently considering a portfolio approach for non-financial items in its finalisation of the hedge accounting project.

However, similar to financial entities, non-financial entities often utilise an open portfolio approach as an inherent part of managing their risk exposures. Consequently, we do not believe that the ED, in its current form, meets the objective as stated in paragraph 1. The reason for this is that the actual risk management strategy is difficult to reflect in the financial statements using a closed portfolio approach.

If non-financial entities are not able to hedge non-financial items on an open portfolio basis, the current operational challenges relating to applying hedge accounting would not be resolved. Consequently, the complexity of hedge accounting would not be reduced in respect of one of today's key challenges. The reason for this is that it is complex and operational burdensome to apply hedge accounting of closed portfolios as it is often inconsistent with entities risk management framework and procedures.

In addition, we struggle to see the conceptual reasoning behind only allowing portfolio hedging of financial items. We therefore suggest that the IASB removes the restrictions relating to open portfolio.

Instead, we believe that the discipline in applying hedge accounting should be related to ensuring that an entity has systems and procedures in place to monitor and measure its risk positions (including that the change in the fair value of the hedged risk and hedging instrument is monitored on an on-going basis). We believe that this approach would lead to a better presentation of an entity's actual risk management strategy in the financial statements.

Consistent with the objective of the ED we therefore suggest that the IASB includes non-financial items in its current project relating to portfolio hedging (i.e., macro hedge accounting).

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?

We agree that entities should be allowed to hedge a specific risk or specific risks, as this is consistent with the manner in which entities manage their risk exposures.

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?

Own-use contracts

We note that in connection with preparing the ED the IASB considered the following three alternatives:

- (a) allowing an entity to elect to account for commodity contracts as derivatives (i.e. a free choice);
- (b) accounting for a commodity contract as a derivative if that is in accordance with the entity's fair value-based risk management strategy; or
- (c) retain the current requirements in IAS 39

We support the IASB's proposal to account for a commodity contract as a derivative if that is in accordance with an entity's fair value-based risk management strategy. We would also like to emphasise that, in our view, the other two alternatives would neither reduce complexity nor solve the current challenges faced by Commodity Processors.

However, we note that it is unclear from the current wording of the amendments whether the derivative accounting is only allowed for contracts which are:

- managed on a fair value basis according to a fair value-based risk management **and** could be settled net in cash; or
- managed on a fair value basis according to a fair value-based risk management irrespective of settlement method.

We believe that if it is a requirement that the contracts should be able to be settled net in cash, the current inconsistencies between the accounting and the risk management strategy / business model of commodity processors will not be removed. Hence, we strongly support that the criteria for measuring contracts at fair value should be whether an entity uses a fair-value-based risk management strategy rather than whether the contracts could potentially be settled net in cash.

In addition, we note that the requirements in IAS 2 relating to the measurement of inventories remain unchanged. Hence, entities that are not commodity broker-traders cannot measure their inventory at fair value, irrespective of the fact that the inventory is an inherent part of the fair-value-based risk management strategy. We therefore suggest that the IASB allows entities which use a fair-value-based risk management strategy to measure both contracts and inventory at fair value. As described in the introduction to AAK's business model and risk management strategy such requirements would match AAK's and similar entities risk management strategy.

We suggest that the amendments to IAS 2 be made as a consequential amendment as part of the IFRS 9 project, as a different timing between IAS 2 and IFRS 9 would result in undue costs in regards to performing hedge accounting of inventories.