

27 January 2011

International Accounting Standards Board  
(IASB)

Dear Sir/Madam,

**Response to ED/2010/13 *Hedge Accounting***

1. I thank the IASB for the opportunity to comment on the aforementioned ED. Before I proceed to articulate my views on this ED, I would like to emphasise upfront that the comments that are expressed herein are solely my *personal views* and strictly do *not* reflect those of any organisation to which I may be associated presently and/or previously in various capacities.

2. I am pleased that the IASB has finally issued this ED on hedge accounting under the final phase of its closely-watched project to overhaul financial instruments accounting. In my opinion, this ED has, in a number of aspects, correctly identified and effectively addressed the key weaknesses of the hedge accounting model under IAS 39. I note that the latter has been widely criticised for being overly rule-based, inflexible and failing to reflect the true economics of risk management. Viewed from this perspective, I think the Board's overarching objective of seeking to achieve a closer alignment between hedge accounting and risk management signifies a step in the right direction for the revamp of hedge accounting under the IFRS framework. In the overall scheme of things, risk management is the genesis of hedge accounting. Thus, it is only sensible and logical that risk management should drive the mechanics of hedge accounting.

3. In terms of the specific changes proposed in this ED, I think the Board has hit the right notes in the following areas:

- Permitting the designation of non-derivative financial assets or liabilities that are measured at fair value through profit or loss as hedging instruments;
- Allowing risk components (other than foreign currency risk) of non-financial assets or liabilities to also be eligible for designation as hedged items, subject to the "separately identifiable" and "reliably measurable" criteria;
- Eliminating the arbitrary IAS 39 hedge effectiveness test of 80 – 125 percent; and

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- Permitting existing hedging relationships that fail the objective-based hedge effectiveness assessment to be rebalanced in situations where the original risk management objective remains valid.

4. I wish I could end this covering letter on the uplifting note that all is well and good with the Board's review of hedge accounting. However, there are a few key concerns that I would like to highlight:

- ***Conceptual basis of other comprehensive income (OCI)*** – In both the proposals on fair value hedges (paragraph 26) and the treatment of undesignated option time value (paragraph 33), the Board has chosen OCI as the “holding area” for the relevant changes in fair value. However, the Board has not explained the conceptual basis for its selection of OCI. I suspect that this is because the Board has not initiated a rigorous conceptual debate and examination of the distinction between “profit or loss” and OCI in the context of performance reporting and financial statement presentation. Absent a clear conceptual basis of what OCI is, I am deeply concerned that it is degenerating into a “dumping ground” for achieving short-term solutions to financial reporting issues;
- ***Potential increase in complexity and implementation costs*** – I am also concerned about the potential practical impact of two proposals in this ED. Firstly, the proposal to introduce separate line items for fair value hedge adjustments [paragraph 26(b)] is likely to impose heavy monitoring costs on preparers, as such amounts would have to be tracked to ensure that they are derecognised together with the hedged item to which they relate. Secondly, the proposal to distinguish the undesignated time value of options by hedged item type and the multiple subsequent treatments for the fair value adjustments (paragraph 33), will inevitably demand more accounting work and tracking by preparers; and
- ***Outstanding conceptual differences with the FASB*** – I observe that the IASB and the FASB continue to have divergent views on various technical issues on financial instruments accounting. The work to reach consensus in these contentious areas has been further impeded by different project approaches and timelines. As reported in the last quarterly progress update issued by both Boards in November 2010, the FASB plans to re-deliberate hedge accounting only in the second quarter of 2011. In the broader interest of realising a single set of high quality global accounting standards, I strongly

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urge the Boards to continue to work closely together to resolve outstanding conceptual differences in all aspects of financial instruments accounting. I also advise the Boards to ensure that these differences are resolved on the basis of sound principles. Taking shortcuts to achieve quick resolutions for the sake of meeting unrealistic timelines is strategically myopic and must be avoided.

5. My response to specific questions posed in the ED can be found in the [Appendix](#) to this comment letter.

Yours faithfully,

*LINUS LOW*

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Question	Comments
<p><b>Question 1</b></p> <p>Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?</p>	<p>In principle, I have no objection to the proposed objective of hedge accounting as expressed in paragraph 1 of the ED. I note and agree with the Board's basis for arriving at the proposed hedge accounting objective. I further concur that the proposed objective is appropriately worded and pitched at the right conceptual level.</p> <p>Hedging is a well-established risk management practice in business. For the financial statements to faithfully capture and represent its economic substance and attendant impact on an entity's financial performance and position, I see a justifiable need for a departure from the general recognition and measurement principles in the IFRS framework. However, for the IFRS framework to be a robust and consistent set of principle-based standards, any exceptions from those fundamental principles must be based on sound reasoning and clear exposition. As such, I think the Board has done the right thing in attempting to establish the purpose and role of hedge accounting within the larger conceptual landscape of the IFRS framework. This signifies a visible improvement from IAS 39, in which there is no explicit justification for permitting hedge accounting.</p>

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<p><b>Question 2</b></p> <p>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?</p>	<p>Conceptually, I am in favour of the Board's proposal to permit the use of non-derivative financial assets and non-derivative financial liabilities measured at fair value through profit or loss as eligible hedging instruments.</p> <p>In my view, this relaxation of the IAS 39 eligibility rules on hedging instruments marks a paradigm shift in the right direction towards a less rule-bound and more principle-based hedge accounting model. In permitting greater flexibility in the use of hedging instruments, I envisage that the new hedge accounting model would better enable entities to more faithfully align their risk management strategies with their accounting of such strategies, thus ensuing in more decision-useful information for investors and other primary financial statement users.</p>
<p><b>Question 3</b></p> <p>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?</p>	<p>In principle, I support the ED's proposal to permit an aggregated exposure that is a combination of another exposure and a derivative to be designated as a hedged item.</p> <p>I agree with the Board's assessment in paragraph BC49 that the existing IAS 39 rationale for forbidding derivatives (or aggregated exposures including a derivative) from being designated as hedged</p>

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	<p>items is conceptually inconsistent with the exceptional provision permitting some purchased options to be designated as hedged items.</p> <p>Indeed, to a very large extent, such exceptional provisions have contributed to the complexity, arbitrariness and rule-based nature of the existing IAS 39 hedge accounting provisions. Basing the new hedge accounting model on consistent principles would facilitate the faithful representation of how exposures could practically be hedged in the real business world. This is in line with the objective of more closely aligning hedge accounting with actual risk management strategies. I welcome this as a step in the right direction for hedge accounting under the IFRS framework.</p> <p>From a practical standpoint though, I envisage that permitting aggregated exposures (including derivatives) to be designated as hedged items could potentially result in some highly complicated hedge accounting situations, considering that the hedged item combinations are now effectively unlimited. The Board – in consultation with leading risk management practitioners – will probably need to provide more implementation guidance for preparers if it ultimately decides to roll out this proposal under IFRS 9.</p>

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<p><b>Question 4</b></p> <p>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?</p>	<p>I think it is sensible to permit an entity to designate as a hedged item in a hedging relationship changes in its cash flows or fair value that are ascribable to a specific risk component, subject to the “separately identifiable” and “reliably measurable” criteria. I am therefore in favour of this proposal.</p> <p>Under the existing IAS 39 hedge accounting model, there is what I perceive to be an arbitrary “bright line” between financial and non-financial items. Specifically, separately identifiable and reliably measurable risk components can be designated as hedged items for the former whereas only foreign currency risk components are permissible as hedged items for the latter. This has created a gap between actual risk management strategies and hedge accounting. I therefore view the proposed change as a step in the right direction aimed at bridging this gap, thereby providing better alignment between actual risk management practices and accounting.</p> <p>That said, I anticipate that it would be more challenging for preparers to disaggregate non-financial items into separately identifiable and reliably measurable risk components for designation as hedged items when these are <i>not</i> contractually specified (e.g. a forecast transaction to procure a non-financial asset at future market prices). Thus, in terms of financial statement impact, I think entities are more likely to</p>

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	<p>designate those risk components of non-financial items that are contractually specified as hedged items vis-a-vis those that are <i>not</i> contractually specified. If so, the financial statements may still not reflect the full extent of an entity's risk management activities. I urge the Board to consider developing more guidance on disaggregating non-financial items that are <i>not</i> contractually specified into separately identifiable and reliably measurable risk components.</p>
<p><b>Question 5</b></p> <p>(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?</p> <p>(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?</p>	<p>(a) I agree and welcome the proposal to permit the designation of a layer of the nominal amount of an item as a hedged item. In reality, uncertainties in terms of quantum and/or timing could arise in respect of hedged items, especially those relating to forecast transactions. My sense is that this proposal would provide preparers with greater flexibility in accounting for such hedging scenarios, thereby bridging the gap between the economics and accounting of risk management practices.</p> <p>(b) In principle, I support the proposal to forbid a layer approach in fair value hedge situations where the prepayment option's fair value shifts in response to the hedged risk. The key hedge accounting principle underpinning a component approach (of which the layer approach is an example) is that the risk</p>

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	<p>component must be separately identifiable and reliably measurable (vide paragraph B13). I agree with the Board's assessment in paragraph BC69 that the identifiability of the risk component is questionable if the prepayment option's fair value changes in response to the hedged risk.</p>
<p><b>Question 6</b></p> <p>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?</p>	<p>By and large, I am supportive of the proposed hedge effectiveness criteria in paragraph 19 of the ED. In particular, I think the removal of the IAS 39 hedge effectiveness test of 80 – 125 percent would significantly reduce the operational burden and challenges presently faced by preparers in applying hedge accounting and promote better alignment of hedge accounting with the entity's actual risk management strategy. I also see merit in the proposal to abolish the IAS 39 retrospective testing of hedge effectiveness. This would minimise the need to de-designate hedging relationships which fail the retrospective hedge effectiveness test owing to transitory and/or marginal market changes.</p> <p>However, I would like to take this opportunity to highlight my concern with the notion of "other than accidental offsetting" in paragraph 19(c)(ii) of the ED. As I see it, this is susceptible to varying degrees of interpretation, depending on an entity's risk management threshold. While I observe that the Board has</p>

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	endeavoured to clarify this notion in paragraph B31 of the ED, I think there is a need for the Board to more clearly and explicitly define what this notion means to pre-empt divergence in practice arising from variations in interpretation. I would think that the existence of a valid economic relationship between the hedged item and the hedging instrument is a key definitional element underpinning the notion.
<p><b>Question 7</b></p> <p>(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?</p> <p>(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?</p>	<p>(a) On a conceptual level, I am in favour of the proposal to permit a rebalancing of an existing hedging relationship in circumstances where the original risk management objective remains unchanged. I think this proposal addresses a key weakness of the existing IAS 39 hedge accounting model, and would more closely align hedge accounting with actual risk management. The IAS 39 “blanket” requirement to discontinue hedging relationships that do not meet the hedge effectiveness test, has resulted in the frequent discontinuation and restarting of hedging relationships. This does not always faithfully reflect the economics of risk management, where adjusting the hedge ratios of existing hedging relationships to achieve more effective outcomes is a well-established practice.</p> <p>However, from a practical standpoint, I foresee that preparers</p>

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	<p>could face significant challenges in operationalising the rebalancing evaluation process as outlined in paragraphs B46 – B60. The evaluation requires substantial judgement and most probably demands additional documentation from preparers to substantiate rebalancing of existing hedging relationships. I suspect that many preparers will find it difficult to comprehend and apply the guidance provided in paragraphs B46 – B60. As I see it, the guidance does not appear to be pitched at the right level to facilitate understanding and application. My feedback is that it is overly conceptual and there are no illustrative examples to elucidate the principles. I therefore urge the Board to revisit and redraft the guidance with a view to facilitating understanding and implementation.</p> <p>Furthermore, as highlighted in my response to Question 6, I also have a concern with the clause “other than accidental offsetting”, which is again used in one of the decision nodes in the chart accompanying paragraph B46.</p> <p>(b) I have no objection to permitting the proactive rebalancing of existing hedging relationships. However, to ensure that hedge accounting and risk management are aligned, I think proactive rebalancing in hedge accounting should be driven by the actual risk management of that specific hedging relationship. In other</p>

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	<p>words, proactive rebalancing in hedge accounting should only be permitted if the entity actually adjusts the hedge ratio of the existing hedging relationship concerned to pre-empt anticipated hedging ineffectiveness.</p>
<p><b>Question 8</b></p> <p>(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?</p> <p>(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? If not, what changes do you recommend and why?</p>	<p>(a) I concur with the proposed condition for discontinuation of hedge accounting as worded in paragraph 24 of the ED. I observe that this is an improvement over IAS 39, which does not accommodate rebalancing of an existing hedging relationship which continues to meet the original risk management objective.</p> <p>(b) I agree with the Board's conclusion that voluntary revocation of an existing hedging relationship should not be permitted if the said hedging relationship still meets the original risk management objective and continues to meet the objective-based hedge effectiveness test.</p> <p>I think this is consistent with the overarching principle that actual risk management should drive the designation and measurement of hedging relationships in the financial statements. The permission that paragraph 91(c) of IAS 39 grants to entities to voluntarily de-designate an existing hedging</p>

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	<p>relationship at will and without reference to the underlying risk management objective and strategy, encourages arbitrariness and is unlikely to result in decision-useful information for the primary users of financial statements.</p>
<p><b>Question 9</b></p> <p>(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?</p> <p>(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?</p> <p>(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?</p>	<p>(a) I do not support the proposed accounting approach for fair value hedges. I believe that the proposal creates additional work for preparers without providing additional information to financial statement users. I also find it difficult to see how the proposed change is superior to the accounting approach under IAS 39.</p> <p>Firstly, the proposal would result in the same effect on profit or loss as the present accounting approach under IAS 39. However, this is achieved in two steps instead of the single step under IAS 39 [i.e. posting the gains or losses on both the hedged item and hedging instrument first to other comprehensive income (OCI), and then transferring the ineffective portion to the income statement]. There is thus no additional information for financial statement users as far as the entity's profit or loss result is concerned.</p> <p>Secondly, I question the Board's conceptual basis for the</p>

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	<p>proposed recognition of the gains or losses on both the fair value hedged item and hedging instrument in OCI. As I had mentioned in my comment letter to ED/2010/5 <i>Presentation of Items of Other Comprehensive Income (Proposed amendments to IAS 1)</i> dated 26 June 2010, I see an imperative need for the Board to initiate a rigorous conceptual debate and examination of the distinction between “profit or loss” and OCI in the context of performance reporting and financial statement presentation. Absent a clear conceptual basis of what OCI is, there is a risk that the OCI classification would degenerate into a “dumping ground” for contentious items. While the Board has explained that its intention in this instance is to achieve presentation of the effects of an entity’s risk management activities for both cash flow and fair value hedges in one place [paragraph BC123(c)], I do not see any justification on why the Board has chosen OCI as the destination for presenting those risk management effects. Unless the Board is able to defend its selection of OCI in robust conceptual terms, my fear is that OCI is degenerating into nothing more than a “dumping ground” for achieving short-term solutions to financial reporting issues.</p> <p>(b) While the Board’s proposed separate line item presentation for the hedged item’s fair value hedge adjustments addresses the</p>

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	<p>“mixed measurement” problem in the statement of financial position to some extent, I think it raises both a conceptual and an implementation issue.</p> <p>On the conceptual front, I am not sure whether this separate line item - in substance a fair value gain or loss - satisfies the definition of either an asset or a liability under the <i>Framework</i>. I urge the Board to consider whether the introduction of such a “valuation adjustment” is conceptually consistent with the key “building blocks” of the statement of financial position.</p> <p>On the implementation side, I envisage that the addition of separate line items for fair value hedge adjustments is likely to impose heavy monitoring costs on preparers. Specifically, these amounts would have to be tracked to ensure that they are derecognised together with the hedged item to which they relate, thereby adding to the complexity of hedge accounting. Investments in accounting system changes may also be required.</p> <p>Considering these two issues together, I have reservations on the benefits of this proposed presentation approach. In my view, disclosure of these fair value hedge adjustments in the notes to the financial statements is a more appropriate and cost-</p>

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	<p>effective solution to the “mixed measurement” problem.</p> <p>(c) I concur with the Board’s conclusion that linked presentation is not appropriate for fair value hedges. In my view, the financial reporting problems that the particular industry has with fair value hedge accounting are context-specific. As such, while linked presentation may satisfy that industry’s financial reporting needs, it may not faithfully present the financial impact of risk management in the context of other industries. To the extent that the IFRS framework is envisaged to be a set of general accounting standards for global adoption, it has to be industry-neutral in order to be relevant to the financial reporting needs of a broad spectrum of industries.</p>
<p><b>Question 10</b></p> <p>(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?</p> <p>(b) Do you agree that for period related hedged items, the part of the</p>	<p>(a) While the Board’s proposed accounting treatment for the time value of an option whose intrinsic value has been designated as a hedging instrument appears to have provided a solution on this issue, I think it still raises the same conceptual issue that I have highlighted in my response to Question 9(a).</p> <p>In particular, unless the Board has rigorously deliberated and finalised the conceptual distinction between “profit or loss” and OCI, I do not see any conceptual basis why the fair value of the</p>

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<p>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?</p> <p>(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?</p>	<p>option’s time value should be deferred in OCI in the first instance. In this context, the Board’s intention is apparently to address the profit or loss volatility consequence under IAS 39, which regards the undesignated option time value component as held for trading (paragraph BC144). In the case of the proposal on fair value hedge accounting in Question 9(a), the Board’s intention was to present in one place the effects of an entity’s risk management activities. I find this rather worrying. It seems to me that the Board is treating the OCI classification as a “dumping ground” for achieving arbitrary solutions at the expense of sound and rigorous principles.</p> <p>From an implementation perspective, I anticipate that the need to distinguish between a transaction related and a time period hedged item [paragraph 33(a)] will probably impose additional costs on preparers. Preparers will need to review their existing option hedging relationships to make and document this distinction. Additionally, the proposed multiple treatments for the fair value adjustments of the time value component of the options subsequent to their accumulation in OCI, will inevitably demand more accounting work and tracking by preparers. Thus, the proposal on accounting for the undesignated time value of options whose intrinsic value are designated as hedging instruments, is likely to add to the</p>

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	<p>complexity of hedge accounting, rather than simplifying it.</p> <p>On the above grounds, I strongly urge the Board to revisit and reconsider the value proposition of this proposal in terms of both conceptual soundness and cost-effectiveness.</p> <p>(b) Please see my above comments to part (a). Further to those comments, I would like to add that the notion of “aligned time value” is likely to contribute to the complexity of hedge accounting and impose additional implementation challenges for preparers. Preparers will not only need to exercise substantial judgement and effort in determining the “critical terms of the option” that are aligned with the hedged item, but also develop theoretical models to estimate the fair value (possibly of the Level 2 or 3 type) of the “aligned time value” of the hypothetical option.</p> <p>Overall, I have serious reservations on the value proposition of this proposed approach to accounting for undesignated option time value. I strongly urge the Board to rethink its position on this issue.</p> <p>(c) Please see my above comments to parts (a) and (b). In the absence of a better approach, I am more inclined to retain the</p>

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	<p>present IAS 39 approach of treating the undesignated option time value component as held for trading and accounting for it on the basis of fair value through profit or loss.</p>
<p><b>Question 11</b> 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?</p>	<p>With respect to <i>gross</i> position hedging of a group of items, I agree with the Board’s proposed eligibility criteria. I note that the proposed eligibility criteria are consistent with those for the hedging of individual items (paragraph BC164). I further observe that the proposed eligibility conditions are more aligned with risk management than the relatively more stringent conditions stipulated in IAS 39. Vide paragraph 83 of IAS 39, for group hedging, there are the additional eligibility conditions that (1) the individual items in that group must share similar risk exposures, and (2) the change in fair value attributable to the hedged risk for each individual item within the group has to be “approximately proportional” to the overall change in fair value attributable to the hedged risk for the group as a whole. In particular, condition (2) is not always consistent with actual risk management for groups of items.</p> <p>I welcome the Board’s proposal to permit the <i>net</i> position hedging of a group of items. I think this proposal addresses another weakness of IAS 39. Paragraph 84 of IAS 39 explicitly forbids <i>net</i> position hedging, and this has created a gap between the IAS 39 hedge</p>

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	<p>accounting model and actual risk management practice.</p> <p>However, I see an inconsistency between the proposed accounting for net position hedging of a group of items vis-à-vis actual risk management practice. Specifically, I have concerns with the principle stipulated in paragraph B73, which essentially requires the gross positions underlying the net position to be designated. In my view, this principle does not faithfully reflect the manner in which an entity hedges a group of items on a net position basis. To be consistent with the economics of net position hedging, I think the aim of aligning hedge accounting with risk management would be better served if this principle is jettisoned in favour of permitting the designation of the net position.</p> <p>Additionally, I do not find the Board's rationale for restricting the cash flow hedge of a net position only to situations where the offsetting cash flows exposed to the hedged risk affect profit or loss in the same and only in that reporting period [paragraphs 34(c) and BC168 – BC173] convincing. I do not see the Board advancing clear principles to substantiate its position on this issue. I urge the Board to review this issue and to furnish a more robust conceptual basis for its position.</p>

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<p><b>Question 12</b></p> <p>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?</p>	<p>I have no issues with the Board’s proposal to present the hedging instrument gains or losses in a separate line item in profit or loss upon reclassification from OCI, in a hedge of a group of items with offsetting risk positions affecting different line items in the income statement. I see conceptual merit in the Board’s argument in paragraph BC175 that adjusting or grossing up all the affected line items could lead to the recognition of gross gains or losses that are fictitious. Thus, I think separate presentation in the income statement of the OCI-reclassified hedging instrument gains or losses would more faithfully reflect the economic substance of net position hedging.</p> <p>However, I do not agree with the presentation approach for fair value hedges proposed in paragraph 38 of the ED. Please see my response to Question 9(a) and (b) for the grounds of my objection to this proposal.</p> <p>In the context of a fair value hedge of a <i>net</i> position, I suspect that the proposal to present in the statement of financial position separate line items of the gross amounts of the gains or losses relating to each associated asset or liability, could well trigger the same “grossing up” problem that the Board was trying to avoid in the case of a group hedge of items with offsetting risk positions affecting multiple line</p>

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	<p>items in the income statement.</p> <p>For fair value hedges in a group context involving both a <i>gross</i> or <i>net</i> position, my sense is that disclosure of the fair value hedge adjustments in the notes to the financial statements would be a better solution.</p>
<p><b>Question 13</b></p> <p>(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?</p> <p>(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?</p>	<p>(a) I note that a critical component of the proposed disclosure requirements is the section proposing cross-tabulations by risk category and type of hedge, which are aimed at providing financial statement users with decision-useful information on the effects of hedge accounting on the primary financial statements (vide paragraphs 49 – 52 and IE1 – IE3). While I appreciate the motivation underlying the Board’s proposal, I am not sure whether such cross-tabulations would be effective in communicating the links between the hedge accounting information presented on the face of the financial statements and the entity’s risk management strategy or approach.</p> <p>I suggest that the Board carry out field-testing with financial statement users to ascertain the effectiveness of such a disclosure approach. For overall consistency, it is also imperative that the Board holistically review the proposed</p>

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	<p>disclosure requirements in this ED with those of the earlier phases of the financial instruments project before finalising and incorporating all the requirements into IFRS 7.</p> <p>(b) At this juncture, I have nothing more to add.</p> <p>However, further to my earlier comment letters to ED/2010/6 dated 16 August 2010, ED/2010/9 dated 16 September 2010 and ED/2010/8 dated 6 November 2010, I would like to reiterate my advice to the Board to consider adopting a more holistic approach to principle-based disclosures through the development of a Disclosure Framework. The present absence of a Disclosure Framework has resulted in the IFRS disclosure requirements being developed on a standard-by-standard basis, without reference to a unifying set of principles espousing disclosure objectives and the extent to which disclosures should support the numbers reported in the financial statements. I hope to see the Board including a project to develop a Disclosure Framework for Financial Reporting in its future technical agenda.</p>

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Question	Comments
<p><b>Question 14</b></p> <p>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?</p>	<p>At this juncture, I have no objection to this proposal. I note that this proposal is primarily intended to provide a cost-effective solution to mitigating accounting mismatches that arise in the case of commodity contracts that presently do not fall within the scope of IAS 39 and have to be accounted for as "executory contracts".</p> <p>However, as the proposal entails amending paragraph 8 of IAS 32 to extend its scope and there are no foreseeable plans to subsume IAS 32 under IFRS 9, I think it would be more appropriate for the Board to make this change in the context of IAS 32 instead of IAS 39. Additionally, the Board should also evaluate the urgency of this change and determine the appropriate due process for effecting the change. As I see it, it is not unthinkable to propose this change as part of the Board's next instalment of its Annual Improvements process.</p>
<p><b>Question 15</b></p> <p>(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?</p>	<p>From a conceptual perspective, I disagree that "...to accommodate hedge accounting for hedges of credit risk, a different hedge accounting requirement specifically for this type of risk component would have to be developed, or the proposed hedge accounting requirements would have to be significantly modified..." (paragraph BC225). In my view, such a standard-setting stance is tantamount to</p>

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Question	Comments
(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?	<p>permitting exceptions at the expense of the fundamental principles on which the proposed hedge accounting model is based. This would clearly be inconsistent with the principle-based standard-setting philosophy that the IASB is committed to.</p> <p>On the above basis, I do not support any of the three alternative accounting treatments that the Board contemplated.</p> <p>I also do not believe that these alternatives truly address the crux of the issue. At issue is the difficulty that financial institutions face in isolating and quantifying the change in fair value of a financial item that is ascribable to credit risk because the spread between the risk-free rate and the market interest rate includes a mixture of various risk components. As I see it, this is more of a risk valuation modelling issue that the financial institutions have to grapple with. The onus therefore should rest on them to develop robust risk valuation models that are capable of isolating and quantifying the fair value changes of the constituent credit risk that they face from holding a certain financial item.</p> <p>In this respect, I would think that the forthcoming <i>Fair Value Measurement</i> IFRS should provide the necessary guidance for these financial institutions. If it is not too late though, the Board may wish to investigate this credit risk measurement issue under the <i>Fair Value</i></p>

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Question	Comments
	<p><i>Measurement</i> project. Alternatively, the Board could consider including this issue as part of its review of the <i>Fair Value Measurement</i> IFRS under the Annual Improvements process.</p>
<p><b>Question 16</b> Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?</p>	<p>I agree that the new hedge accounting model should apply prospectively. The retrospective application principle in IAS 8 is not relevant in this context, considering that it would be incongruent with the proposed principle that a hedge accounting relationship can only be designated prospectively.</p> <p>As for the proposed effective date of the new hedge accounting model, I concur with the Board that it should be aligned with the effective date for IFRS 9, and that earlier application should be permitted provided all existing IFRS 9 requirements have already been adopted or will be adopted together with the new hedge accounting requirements. However, I strongly urge the Board to consider whether the proposed absolute effective date of 1 January 2013 remains viable in light of feedback received from its recent request for views <i>Effective Dates and Transition Methods</i>.</p>

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