



9 March 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

Dear Sir David

EXPOSURE DRAFT ED/2010/13 HEDGE ACCOUNTING

Origin Energy Limited (Origin) welcomes the opportunity to comment on the proposals made by the exposure draft (ED) and appreciates the IASB's commitment to improving the hedge accounting requirements.

We agree with the overall intent and objective of the ED and in the majority we support the specific proposals within the ED. We do have a number of comments in relation to matters of detail regarding the proposals which are captured below in the responses to the specific questions in the ED.

Yours sincerely

Gary Mallett
Group Financial Controller

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Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

We agree with the proposed objective if it is designed only to represent hedge accounting as an income statement timing mechanism. Clearly risk management strategies cover a significantly greater spectrum of activities, with management of risks which do not necessarily impact profit or loss. If part of the intention of the objective is to clearly limit the scope of risk management activities covered by hedge accounting to those impacting the income statement, then we agree that the objective is appropriate.

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

We agree. Hedge accounting should apply equally to derivative and non-derivative hedging instruments. Risk management strategies which use non-derivative hedging instruments to manage risks which could affect profit or loss should not be excluded from hedge accounting purely as a result of the non-derivative character of the hedging instrument.

Question 3

Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

We agree. This is consistent with many risk management strategies and ensures that the hedge accounting outcomes for such strategies more accurately reflects the substance of the economic hedging arrangement in place. This was a significant weakness in the existing IAS 39 rules and the proposals address this.

Question 4

Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

We agree. This is consistent with many risk management strategies and ensures that the hedge accounting outcomes for such strategies more accurately reflects the substance of the economic hedging arrangement in place.

Question 5

- a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?***
- b) Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the***

option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

- a) We agree. This is consistent with many risk management strategies and ensures that the hedge accounting outcomes for such strategies more accurately reflects the substance of the economic hedging arrangement in place.
- b) We have no specific comment on this proposal.

Question 6

Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

We agree. The proposals contained in the ED represent a significant improvement, particularly in relation to:

- removal of the arbitrary 80-125% effectiveness criteria boundaries
- greater use of qualitative assessment

As effectiveness measurement and testing is a fundamental foundation of hedge accounting requirements, we would strongly suggest additional guidance be provided through further application guidance to assist those applying the requirements.

Question 7

- a) *Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?*

- a) We agree.
- b) We agree.

Question 8

- a) *Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?*
- b) *Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?*

- a) We agree that an entity should discontinue hedge accounting prospectively when the hedging relationship ceases to meet the qualifying criteria. However, we do not see the need to limit an entity's ability to prospectively discontinue hedge accounting for reasons unrelated to the qualifying criteria.
- b) We do not agree. We do not see the need to limit an entity's ability to prospectively discontinue hedge accounting for reasons unrelated to the qualifying criteria.

Question 9

- a) *Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?*
 - b) *Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?*
 - c) *Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?*
- a) We do not agree. We have no concerns with the existing fair value hedging recognition and related disclosure requirements. Accordingly, we do not see the need for the proposed change or any resulting value to users of the financial statements arising from the change.
 - b) Based on our response to a), we do not see the need for this proposal.
 - c) We agree, in the context of our comments to a) and b).

Question 10

- a) *Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (eg like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?*
 - b) *Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?*
 - c) *Do you agree that the accounting for the time value of options should only apply to the extent that the time value relates to the hedged item (ie the 'aligned time value' determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?*
- a) We agree. This principle is consistent with the reclassification requirements for all other amounts recognised in other comprehensive income for non-option hedging instruments in the manner and character which matches the recognition in profit or loss of the relevant offsetting part of the hedged item.
 - b) We agree. This principle is consistent with the requirements to transfer to the profit or loss all other amounts recognised in other comprehensive income for non-option

hedging instruments in the manner and character which matches the recognition in profit or loss of the relevant offsetting part of the hedged item.

- c) We agree conceptually. Significant challenges may occur in practice in differentiating between the components. In cases where the difference is not material, there would be an administrative cost to entities with no additional value for users. Accordingly, providing additional application guidance in this area in regard to critical terms would be beneficial.

Question 11

Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

We agree.

Question 12

Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (eg in a net position hedge), any hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

We do not agree. The result of both the hedged item and hedging instrument should be presented consistently regardless of whether the hedging relationship is a gross or net position hedge. The proposal risks the loss of comparability of financial statements between entities based on whether they gross or net hedge, despite their ultimate risk management outcomes being identical. The proposal also appears to impair a user's ability to assess the results of an entity's risk management strategy with respect to specific risks as the results of all such risks being aggregated in one line, rather than presented in the lines of the related hedged items.

Question 13

- a) ***Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?***
- b) ***What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?***

We support the intention of providing more effective information for users of financial statements in relation to risk management and hedge accounting. However we do not support the inclusion of additional line items in the primary statements as a method of achieving the intent as we do not believe this to be more effective. In addition, the disclosures proposed in relation to specific forward-looking details of the hedged items and related hedging instruments (including notional amounts and hedge rates) will be onerous to prepare and in many cases may result in a conflict with confidentiality provisions or the release of competitive or commercially sensitive information.

Question 14

Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be

settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

We agree. The proposals provide entities with commodity contracts the ability in certain circumstances to align the accounting outcomes with the economic outcomes of their commodity transactions and related risk management strategies.

Question 15

- a) Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?***
- b) If not, which of the three alternatives considered by the Board in paragraphs BC226-BC246 should the Board develop further and what changes to that alternative would you recommend and why?***

We have no specific comment on this proposal.

Question 16

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

We do not agree. Significantly, the restriction to only *prospectively* designate all existing hedging relationships under the new requirements leads to a lack of consistency and comparability for those hedging relationships which did not qualify under the existing rules but do qualify under the proposed new requirements. Where such hedging arrangements were clearly part of the entity's documented risk management strategy, but were unable to be designated under IAS 39, it is inappropriate and potentially misleading in our view to effectively taint the future financial statement outcomes with the legacy of the accounting treatments of particular instruments which were required under IAS 39. Where a hedging arrangement has been consistently captured within the entity's risk management strategy from its inception, full retrospective application of the new proposals to that hedging strategy and the necessary adjustments to the financial statements at the date of adoption of the new proposals is the appropriate method to ensure the useability of the financial statements are not impaired. Prospective-only designation will also prejudice the future effectiveness of the relationships which meet the proposed criteria but which did not meet the existing criteria as a result of the non-zero fair value of the hedging instrument at the inception of the hedging relationship (date of adoption of the new standard). Fully retrospective application would remove this bias and ensure an appropriate and untainted future for such relationships. It should be noted that a number of the designation decisions made by entities on initial adoption of IAS 39 in 2005 were forced by the rigid rules based approach of IAS 39 at that time, and were inconsistent with the risk management strategies applied. It is critical that this can be corrected on initial adoption of the new requirements to ensure that the financial statements in future periods are not continuously tainted by this legacy.

In particular, a number of existing hedging relationships may need to be restructured or designated differently under the new requirements - specifically:

- option-based hedging strategies that did not satisfy the old criteria

- combinations of exposures and derivatives that were designated as fair value hedges previously (with the additional derivatives in the risk management arrangement remaining non-designated) because of the inability to designate the entire economic hedging structure for hedge accounting purposes.

Many entities have long-dated hedging instruments and relationships (many 20 years and more into the future) which will not be able to be correctly designated without full retrospective application of the new requirements and transitional adjustments to the financial statements to reflect the full retrospective application from the inception of the risk management arrangement. Prospective application to these arrangements will result in significant administration and potentially misleading financial outcomes as a result of the need to continue to account for the rolloff of the amounts recognised in the financial statements (as at the date of adoption of the new standard) for these hedging arrangements that were created under the old IAS 39 requirements.

More clarity is required in regard to a number of specific areas related to the transition adjustments required at the date of adoption of IFRS 9 including:

- fully retrospective transition requirements and initial adoption adjustments for the time value of option-based hedging relationships which qualify at the date of adoption of IFRS 9, but were not previously designated. For option-based hedging strategies that previously did not meet the requirements to enable designation under IAS 39, but were within the entity's documented risk management strategy, it is inappropriate to only apply the requirements prospectively.
- fully retrospective transition requirements and initial adoption adjustments for hedging relationships where combinations of exposures and derivatives are the hedged item. Specifically in relation to:
 - the combination of foreign fixed rate debt and cross currency interest rate swaps (fixed to floating) which are currently designated in fair value hedging relationships (due to limitations in the current IAS 39)
 - and the derivatives which hedge the synthetic local floating rate debt created by this combination but are currently unable to be designated for hedge accounting purposes and therefore have been recognised at fair value through profit and loss
- fully retrospective transition requirements and initial adoption adjustments for hedging relationships which failed the 80-125% arbitrary effectiveness boundary under the existing requirements, but which were always part of the entity's documented risk management strategy and now meet the newly proposed criteria. Without fully retrospective application, such hedging relationships will be required to be designated at the date of adoption of the new proposals, with future effectiveness tainted by the non-zero fair value of the hedging instrument at the inception of the relationship. This is a perverse and illogical outcome.

Where full retrospective application of the new requirements to existing hedging arrangements (for those which meet the new criteria at the date of adoption and throughout the life of the arrangement to that date) and the related adjustments to the financial statements at the date of adoption are not provided for under the transitional provisions of the standard, significant distortion of the financial statements will occur, leading to a loss of comparability and usefulness. We therefore strongly encourage reconsideration of the transitional requirements and the related application guidance.