

International Accounting Standards Board
First Floor
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London
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UNITED KINGDOM

8 March 2011

Dear Sirs

Exposure Draft ED/2010/13 Hedge Accounting ("ED")

Thank you for the opportunity to comment on the ED. Fonterra Co-operative Group Limited ("Fonterra") has reviewed and considered the ED and welcomes the opportunity to submit our comments.

Overall, we broadly support the proposals in the ED. We agree with the proposed objective of hedge accounting and the flow on implications of that objective to areas such as effectiveness testing, allowing hedge accounting for risk components of non-financial items, and allowing aggregated exposures that include derivatives to be designated as hedged items. We believe these changes will allow Fonterra's financial statements to more appropriately reflect the economic risk management activities that we undertake.

However there are certain areas of the proposals where we believe additional consideration is required. In particular, while we agree that disclosures about hedge accounting are important for users of financial statements, we strongly recommend that aspects of the proposed disclosure requirements be reconsidered to ensure they are appropriate in a commercial context.

We provide comments in detail in responses to the relevant questions in the ED, in Appendix 1 of this letter.

Background

Fonterra is a leading multinational dairy company owned by approximately 10,400 New Zealand dairy farmers. We are the world's largest exporter of dairy products, with a global supply chain that encompasses our shareholders' farms in New Zealand, through to customers and consumers in more than 140 countries.

Please contact me if you wish to discuss any of the matters raised in this letter.

Yours faithfully



Jonathan Mason
Chief Financial Officer

Cc: New Zealand Financial Reporting Standards Board

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?

Yes, we agree with the proposed objective of hedge accounting to represent in the financial statements the effect of an entity's risk management activities that use financial instruments to manage exposures arising from particular risks that could affect profit or loss. In our opinion this proposed objective provides an appropriate underlying principle whereby hedge accounting better reflects the effects of our risk management activities. It also has corresponding flow on effects in creating a more principles-based approach to hedge accounting.

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?

Yes, we agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item. We agree because this reflects entities' economic hedging activities, and is an appropriate outcome of the proposed objective of 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?

Yes, we agree that an entity should be able to designate risk components as hedged items in certain circumstances. In our view this is a logical outcome of the proposed objective of hedge accounting, and will allow financial statements to better reflect risk management activities.

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?

Yes, we agree with the hedge effectiveness requirements proposed in the ED. In our opinion, the proposed elimination of the "bright line" 80 – 125% effectiveness test, and its replacement with an objectives-based assessment, is consistent with the revised objective of hedge accounting. It will allow better representation of the impact of risk management activities in our financial statements as it is more closely linked to our risk management objectives and strategies. It will also enable more efficient effectiveness testing, and remove the arbitrary and at times extreme impact of discontinuing hedge accounting when hedging relationships fall just outside the bright line parameters.

However we do have concerns with the approach that auditors and regulators may take to these more principles-based requirements. We would be concerned if audit firms or regulators were to determine their own quantitative guidelines that may have the effect of reinstating a variant of the bright line test without due process, and in a manner that is inconsistent with both the requirements and the spirit of the proposed IFRS.

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?*

We disagree with the restrictions on discontinuing hedge accounting.

We recommend that the International Accounting Standards Board ("IASB") further consider the important question of the cost vs. benefit aspects of hedge accounting. Underpinning the decision to undertake the costly and time consuming process of hedge accounting is an ongoing (either explicit or implicit) cost vs. benefit analysis. If any entity's analysis changes so that the costs of hedge accounting outweigh the benefits then we do not consider it appropriate that accounting standards require an entity to continue to hedge account and carry the administrative burden of doing so.

For example, company A is hedge accounting and its ownership and therefore the users of its financial statements change. The new owner may not change the risk management objectives or strategy of their new subsidiary, however the new owner may not undertake hedge accounting itself as a different cost vs. benefit analysis has been made for the new owner's group of companies. In our view it is inappropriate to require company A to continue hedge accounting, and incurring the costs of doing so, in such a situation.

Voluntary discontinuance of hedge accounting could be dealt with via disclosure requirements, including a requirement to differentiate the impact of discontinuance between that due to ineffectiveness, separately from the impact of voluntary discontinuance. Paragraphs 50(a)(ii), 50(b)(ii), and 51(c)(ii) of the ED could be expanded to require this additional granularity of disclosure.

Question 9

- (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 on the statement of financial position? Why or why not? If not, what changes do you recommend and why?*

We disagree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item on the statement of financial position. We disagree because:

- We do not perceive that the mixed measurement model that IFRS preparers currently generally use causes confusion for financial statements' users.
- In our view, presenting these "gain or loss on hedged item attributable to the hedged risk" items will, on balance, be confusing for users of financial statements.
- Presenting these additional items on the face of the statement of financial position will add to the increasing level of information that IFRS requires in the primary statements, and detracts from the accessibility and usefulness of the primary statements.

We recommend that an alternative approach is to require this information to be disclosed either in the notes to the financial statements, or on the face of the statement of the financial position. If this information is disclosed in the notes, then it will still be available to the more sophisticated users who are interested in this level of detail.

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 agree that where hedge accounting is material, it is important that entities disclose information about risk management strategies, and how risk management and hedging activities impact financial statements. Such information is useful and relevant to users of financial statements. We therefore agree with some components of the proposed disclosure requirements.

However we disagree with the requirement in paragraph 46 of the ED to disclose information about future periods. In order to meet the requirements proposed by paragraph 46, it may be necessary to disclose information about, for example:

- Forecast sales or purchases volumes.
- Forecast cash receipts or payments for sales, purchases, or borrowings.

- Forecast information about the proportion of risk exposure being hedged, in relation to total forecast exposure.

In our view such disclosures are inappropriate and unnecessary because:

- They will result in disclosure of highly commercially sensitive information.
- Forecast information in relation to hedging activities may, for valid reasons, vary from other forecast information that may be available to the market, however differences would require senior management to invest significant time and resources in activities such as:
 - explaining valid differences;
 - considering whether changes in forecast hedging information must be disclosed to the market under market-based continuous disclosure obligations; and
 - ensuring that a small subset of total internal forecasts is disclosed in a manner which is not misleading or used out of context, for example, because the forecast required by the ED does not present a complete picture of forecast financial information for an entire entity.
- They could expose entities to increased risk in commercial negotiations with derivative counterparties, who would have access to forecast information that would not normally otherwise be available to them.
- These outcomes are based purely on an entity's decision to hedge account. For example, entities A and B have the same risks, risk management objectives and strategies, and hedging activities. Entity A chooses to hedge account, while entity B does not. Entity A would be disclosing significantly more forecast information in its financial statements based solely on its decision to hedge account, than entity B would disclose. This is simply by virtue of an accounting decision.
- We do not consider it appropriate that an entity be discouraged from meeting the needs of genuine users of financial statements by hedge accounting, on the basis that doing so would expose an entity to increased risk of anti-competitive behaviour.
- The existing level of disclosures that IFRS requires in respect of risk management and hedge accounting are voluminous. Increasing the level of disclosures required without substantial justification for doing so adds to the risk that users are unable to extract the important and relevant information from the financial statements, and that therefore additional disclosure results in the information in financial statements becoming less useful.

In our view, the proposed disclosures excluding paragraph 46 would meet the needs of financial statements' users in achieving the overriding objectives of the disclosures as explained in paragraph 40 of the ED.

Question 16

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

We agree with the transitional requirements. We consider that these requirements are pragmatic and practical to implement.