

International Accounting standards Board  
30 Cannon Street  
London EC4M 6XH  
UNITED KINGDOM

9 March 2011

Submitted electronically through the IASB website ([www.iasb.org](http://www.iasb.org))

Dear Sir / Madam,

**Re: ED/2010/13 Hedge Accounting**

We welcome the opportunity to provide comment on Exposure Draft 2010/13 Hedge Accounting (ED).

Anglo American is one of the world's largest mining companies, operating in Africa, Europe, the Americas, Australia and Asia. As an entity that engages in various risk management activities through the use of hedging, the proposals for hedge accounting are highly relevant to our organisation. Our overall comments are presented immediately below, with more detailed answers to the specific questions posed included in Appendix A where relevant.

We are broadly supportive of the proposals set forth in the ED. In particular, we believe that moves to more closely align hedge accounting with the risk management activities of entities is a crucial element of improving the quality of financial reporting. We are also supportive of the IASB in developing an approach that is based more on principles than complicated and restrictive rules. While we support many of the specific amendments such as allowing non-derivative financial assets and liabilities to be designated as hedging instruments and the treatment of aggregated exposures as hedged items, we have certain specific concerns that are summarised below and discussed in greater detail in Appendix A in our responses to the questions posed.

In particular, we have a concern that the proposed objective of hedge accounting is too narrow in that it only refers to exposures that could affect profit or loss. We believe the application of hedge accounting should be permitted for exposures that may not affect profit or loss, such as equity investments designated at fair value through other comprehensive income. We also consider the proposed changes pertaining to accounting for fair value hedges add minimal incremental value. Specifically, we do not consider the recognition of gains and losses on the hedged item and hedging instrument in other comprehensive income provide any specific benefits. The proposed presentational change which requires a separate balance sheet caption to reflect the gain or loss on the hedged item will add complexity to the statement of financial position and is unnecessary. Finally, we believe that the disclosure requirements will not result in an improvement to the quality of financial statements, are onerous for preparers and may discourage the application of hedge accounting in practice.

**A member of the Anglo American plc group**

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Overall we believe the proposed changes will allow entities to more closely align hedge accounting outcomes with risk management strategies. In this regard, we consider the proposed changes an improvement from the current requirements under IAS 39. However, as discussed above and in Appendix A, we consider there are numerous proposals that do not add value and may discourage the application of hedge accounting. If such issues are not addressed, we consider the proposed overall objective of hedge accounting as set out in the ED will not be fully achieved.

Please do not hesitate to contact us should you have any questions or would like to discuss our comments in greater detail.

Yours faithfully,



Laura Flowerdew  
Group Financial Reporting Manager  
Anglo American plc

## Appendix A

We have commented below on those areas most relevant for the Anglo American Group.

### 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?**

#### Response:

We broadly 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.' We are supportive of a more principles-based approach that would allow preparers of financial statements to more closely align accounting outcomes with risk management strategies.

However, we consider there may be situations where an entity engages in risk management activities, even though profit or loss will never be impacted, which should also be addressed in the standard. For example, an entity may elect to hedge the downside price risk of an equity investment designated at fair value through other comprehensive income in accordance with IFRS 9. In this case the application of hedge accounting would be prohibited as the underlying exposure of such investments will never affect the income statement (with the exception of dividends received). Such a scenario would result in an accounting mismatch whereby the recognition of fair value movements in the hedging instrument would be recognised in the income statement, with fair value movements of the hedged item recognised in other comprehensive income. We consider there are other examples where entities may economically hedge transactions (e.g. proceeds of rights issues) without impacting profit or loss. Consequently, we believe the proposed objective of hedge accounting will still result in accounting mismatches and the misalignment of accounting outcomes with risk management strategies.

While we acknowledge the operational issues posed by allowing hedge accounting on items that will never affect profit or loss, disallowing hedge accounting in these cases contradicts the primary principle set forth in the ED in aligning accounting outcomes with the underlying risk management strategy. We therefore believe hedge accounting should also be permitted on exposures that may not affect profit or loss. We do not believe this would be inconsistent with the framework, given the nature of the hedged item is impacted by an entity's decision to designate it as a hedged item. We ask the Board to reconsider whether hedge accounting may be applied in instances where the income statement may not be affected.

### 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?**

#### Response:

We support the inclusion of non-derivative financial assets and liabilities as eligible hedging instruments and consider this will assist with the closer alignment of an entity's risk management objectives and the accounting outcomes.



**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?**

Response:

As noted in BC50, entities may frequently enter into transactions that result in more than one exposure to risk (e.g. interest rate and foreign currency risk). Depending on an entity's risk management strategies, such exposures may be managed by entering into derivative instruments. The aggregated exposure created by the combination of the transaction itself and the derivative instruments may be viewed as a single exposure by an entity and managed accordingly. We therefore support the Board's conclusion that an aggregated exposure that includes an instrument that has the characteristics of a derivative should not preclude designation as a hedged item. We believe this change will assist entities in matching risk management strategies with hedge accounting outcomes.

**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?**

Response:

We agree with the removal of the restrictions that exist under IAS 39 in not allowing risk components of non-financial assets and liabilities to be designated as hedged items. Where various risk components are separately identifiable and measurable, entities should be allowed to designate changes in the cash flows or fair values of such risks as hedged items. We further agree with the conclusion that such risk components should be eligible for hedge accounting whether they are contractually specified or not. We consider these changes will help align hedge accounting practices with risk management activities and the underlying nature of transactions entered into by many entities.

**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?**

We agree with the proposals to allow an entity to designate a layer of the nominal amount of an item as the hedged item for existing transactions, including firm commitments.

**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?**

Response:

We agree with the proposal to eliminate the 80-125 per cent 'bright line' for testing whether a hedge relationship qualifies for hedge accounting. We believe that under IAS 39 entities are often precluded from applying hedge accounting despite legitimate risk management practices and outcomes.

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We broadly agree with the hedge effectiveness requirements as set out in paragraph 19(c) of the ED and as follows:

"The hedging relationship meets the hedge effectiveness requirements if it:

- i. Meets the objective of the hedge effectiveness assessment (ie to ensure that the hedging relationship will produce an unbiased result and minimise expected hedge ineffectiveness); and
- ii. Is expected to achieve other than accidental offsetting."

In particular we support the focus of effectiveness testing being more objective based. We further agree that the objective of a hedge effectiveness assessment is to ensure that the hedging relationship will produce an unbiased result and minimise hedge ineffectiveness. However, we note that situations may arise where an entity cannot utilise a hedging instrument that will completely eliminate hedge ineffectiveness. For example, a thin market may exist for a theoretically optimal hedging instrument, the cost of entering into an ideal hedging instrument may be excessive or a hedging instrument with a period that perfectly matches that of the underlying exposure may not be available. In these cases an entity may utilise a hedging instrument that, while not completely eliminating hedge ineffectiveness, will act in a manner that closely simulates an optimal hedging instrument and therefore minimises hedge ineffectiveness. We believe the IASB should clarify that the use of such hedging instruments does not preclude them from being designated into formal hedging relationships.

We are also supportive of the proposals that allow an entity to use an effectiveness testing methodology that captures the relevant characteristics of the hedging relationship, including the source of hedge ineffectiveness. Allowing qualitative criteria to be used as an alternative to quantitative testing in certain situations will help lessen the administrative burden on entities without detracting from the quality of information provided.

**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?**

Response:

We agree that where the hedging relationship fails to meet the objective of the hedge effectiveness assessment (i.e. an unbiased result and minimise ineffectiveness) an entity should be required to rebalance or discontinue the hedging relationship. We believe that allowing an entity to rebalance a hedging relationship is an improvement on the requirement in IAS 39 to discontinue such a hedge and better reflects the manner in which changing circumstances are managed by an entity in managing risk. Continuation of a hedging relationship where the underlying objectives of the hedge remain the same is more appropriate than the required discontinuation of a hedge relationship.



**(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?**

Response:

We agree that an entity should be permitted to rebalance the hedging relationship proactively if it believes the relationship may fail to meet the effectiveness assessment in the future. We believe proactive rebalancing should be at an entity's discretion and not be mandatory.

**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?**

Response:

We agree that an entity should discontinue hedge accounting prospectively where the hedging relationship no longer meets the qualifying criteria and the relationship cannot be rebalanced. We believe an entity should have the option of de-designation of a hedging relationship at any point in time as discussed in our response to question 8(b) below.

**(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?**

Response:

While acknowledging the rationale for the Board's conclusion, we do not agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship for a number of reasons. On inception of a hedge, an entity may voluntarily not designate a hedging instrument into a formal hedging relationship, even though that hedging relationship may be effective and complies with the entity's risk management objectives and strategy. It would appear inconsistent to only require hedge accounting to be applied in circumstances referred to in the ED, where in other cases an entity may not apply hedge accounting despite the hedge relationship meeting the risk management objective and strategy. In addition, given the onerous disclosure requirements and effectiveness testing requirements, an entity may determine that the costs of applying hedge accounting outweigh the benefits. Provided the entity appropriately accounts for the hedging instrument (generally as a derivative instrument) we do not agree an entity should be required to apply hedge accounting in such circumstances. Finally, we consider such a rule may be ineffective in practice as entities may be able to overlay instruments that achieve the same accounting outcomes. Ultimately, such a requirement may discourage entities from applying hedge accounting upon inception of a hedge relationship, which would appear in stark contrast to the Board's underlying objectives.

**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?**

Response:

We do not agree that the gain or loss on a hedging instrument and the hedged item should be recognised in other comprehensive income. There would appear to be no conceptual basis for this change which, in practice, would seem to have no real impact. While acknowledging the proposed change would provide information in the statement of comprehensive income about the degree of offsetting achieved for fair value hedges in their entirety, this is unlikely to be of any benefit to users in assessing the effectiveness of an entity's risk management activities for two reasons. Firstly, such information is unlikely to be presented at a level of disaggregation that would allow for meaningful analysis. Secondly, such disclosures would not apply to hedging activities that are not designated into hedging relationships, thereby providing no relevant information about an entity's 'real' hedge ineffectiveness. Consequently, we believe this proposal will not provide incremental benefits to users and, given the added complexity in the primary statements, may lessen comparability between entities.

Overall it would appear as though this change adds complexity for preparers without providing any meaningful benefits to users. Further, we generally do not support requirements that will act to increase complexity in the primary statements, particularly relating to such complicated matters as hedge accounting. We believe the current approach of accounting for changes in the fair value of the hedging instrument and hedged item in profit or loss provides information of the same quality and is simpler in application. We are therefore unconvinced that this change is appropriate.

**(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?**

Response:

We believe the presentation requirements as proposed add complexity to the statement of financial position and provide no incremental benefits. We also have reservations about whether the separate presentation of fair value adjustments to hedged items on the statement of financial position is supportable under the Framework. The fair value adjustments only arise as a result of the application of hedge accounting and may not, on a stand-alone basis, be representative of a separate asset or liability. Consequently, we do not consider the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line in the statement of financial position.

**(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?**

Response:

We believe that linked presentation should not be allowed. We consider adding complexity to the statement of financial position should be minimised, with sufficient disclosures provided in the notes to the financial statements.



**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?**

Response:

We agree with the proposal that for transaction related hedged items, changes in the fair value of an option's time value should be accumulated in other comprehensive income and reclassified according to the general requirements. The treatment of the time value of the option should align with the nature of the transaction to which the option relates and management's risk management strategy. As noted in BC146, the time value of an option may be indicative of a premium paid for protection against risk. For a transaction related hedged item, the costs of this protection should be capitalised as a basis adjustment (if related to a non-financial asset) or, if related to a sales transaction, taken to profit or loss at the time the underlying sale impacts the income statement.

**(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?**

Response:

We also agree that for period related hedged items, the time value that relates to the current period should be transferred from other comprehensive income to profit or loss on a rational basis. We believe the implementation guidance of the final standard should provide examples of what constitutes a rational basis.

**Question 13**

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

Response:

We have concerns that the disclosures required by the ED are cumbersome and will result in additional cost to preparers whilst providing minimal incremental value to users. In particular, the detailed requirements of paragraphs 45 – 52 appear highly granular, complex and overly prescriptive. As a result we have doubts that the disclosures will ultimately be effective in providing useful information that will impact decisions made by users on resource allocation. We consider more principles-based disclosures that allow an entity to provide sufficient and relevant information relating to risk management activities would be more beneficial to users.

A major concern we have with the proposed disclosure requirements is that entities may be discouraged from applying hedge accounting given the onerous requirements of the disclosures or concerns relating to the disclosure of commercially sensitive information. Where an entity is required to provide detailed information about hedging strategies that provide competitors with information about forecast output, etc, entities may elect to not apply hedge accounting to achieve exemption from disclosure requirements. This will result in an outcome that is in contrast to the overriding objective of more closely aligning risk management activities with accounting outcomes. Another outcome of the proposed disclosures will be substantially different disclosures between two entities that have identical risk management strategies,



though one elects to apply hedge accounting and the other does not. This has the effect of reducing comparability and will act to discourage entities from applying hedge accounting generally. Disclosures relating to risk management activities should be based on the nature of the activities undertaken and not whether an entity opts to apply hedge accounting.

The detailed tabular disclosures by risk category require a substantial amount of information that we consider are unduly onerous and will detract from the quality of financial reporting by requiring voluminous disclosures that may distract users from more crucial information. While we acknowledge that such disclosures are made at the entity's discretion in accordance with paragraph 43 guidance, concerns of non-compliance may result in the provision of excessive information. Further, the disclosures are required to be made separately for each category of risk, though the Board has provided no meaningful guidance on assessing risk categories. This may result in substantial divergence in practice as entities present risk categories to varying degrees of disaggregation. Should the Board conclude that such disclosures by risk category are necessary, we urge the Board to provide more detailed implementation guidance that will help to ensure disclosures are implemented consistently and are proportionate to the underlying scale of risk management activities.

We also do not support the required preparation of a reconciliation of other comprehensive income that differentiates amounts recognised regarding the time value of options between transaction related hedge items and period related hedge items. Such amounts are unlikely to be material for many entities and disclosure should only be required where an entity considers it is necessary to allow users to understand and interpret the statement.

While detailed disclosures on hedging may be applicable and useful for some specific entities, we believe the required disclosures may detract from the overall usefulness of financial statements for many entities by providing too much generic information and not allowing preparers to focus on key risk areas. We encourage the Board to consider disclosures that are based on sound principles, although allow sufficient flexibility for preparers to focus on the provision of information that is succinct and meaningful.

#### **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?**

#### Response:

Where an entity has a risk management strategy that is based entirely on fair value, we agree that derivative accounting should apply to contracts that can be settled net in cash that are 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. Such a change would, for entities that manage their entire business on a fair value basis, alleviate the need to apply complex hedge accounting strategies while allowing fair value movements to be appropriately reflected in the income statement.

**Question 16**

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

Response:

We agree with the transition requirements as outlined in the ED. Specifically, we agree with prospective application and that compliance with disclosure requirements is not required for the comparative period in the year of adoption.

We do wish to highlight that implementation of the proposed changes will require effort and cost in terms of both financial statement presentation and business process. Organisations will need to spend substantial time and effort training staff internally, while ensuring that a full and proper assessment of hedges (both from an accounting and economic perspective) are assessed prior to the Effective Date. Given the complexity of many hedging issues, this process may be substantial for many entities. In addition, entities will need to communicate and educate users of financial statements on the likely impacts. For these reasons, we believe that the proposed effective date of 1 January 2013 should be delayed if the IASB is not in a position to finalise the standard by June 2011.

We would like to thank you for considering our comments on the proposals for hedging.