



International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

1 March 2011

**RE: Exposure Draft (ED / 2010 / 13) – Hedge Accounting**

Dear Sir / Madam,

Thank you for the opportunity to comment on your Exposure Draft – Hedge Accounting (ED) and, on behalf of Tata Steel Europe Limited, I have outlined our comments on this ED below.

Our detailed responses to each of your questions raised in the ED are set out in the appendix to this letter. However, in summary, we recognise and agree with the Board's proposals to remove some of the current restrictions that are contained within IAS 39 'Financial Instruments: Recognition and Measurement' and move to a principle based standard that looks to more closely align an entity's hedge accounting with its own risk management objectives and the underlying economics of the transactions being entered into.

In particular, we support the proposal that removes the current rule preventing derivatives from qualifying as hedged items as this is not aligned with the economic reality in some circumstances and, therefore, results in an entity not being able to match its hedge accounting with the objectives of its risk management measures. We also support the Board's proposed removal of the somewhat arbitrary and onerous 80-125 per cent 'bright line' effectiveness test and believe that its replacement with an objective based assessment is more in line with economic reality. We favour the proposal to remove the retrospective hedge effectiveness testing as this will minimise the circumstances where a hedging relationship is de-designated as a result of market changes that cause the hedge to fail this retrospective test.

In implementing the requirements of this ED we would, however, encourage the Board to consider the use of a single adoption date for this and other current developments on its agenda to avoid, where possible, entities having to adopt new standards over multiple reporting periods. We are also supporters of clear and concise disclosures within corporate reporting, but note the increased disclosure requirements that have been within the Board's more recent EDs. We believe that there should be a detailed cost/benefit review of these disclosure levels undertaken at some stage in the near future, that looks at financial reports and accounts in their entirety rather than on a standard by standard basis.

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Page 2 of 8

I trust that you find our comments useful within the next stage of the development of the accounting requirements in this area.

Yours sincerely

A handwritten signature in blue ink, appearing to be 'KG' with a flourish.

Ken Grierson  
Director, Reporting & Control  
Tata Steel Europe Limited



## **APPENDIX**

### **Question 1**

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

Given that there is no stated objective for hedge accounting within IAS 39, we agree with the introduction of a proposed objective of hedge accounting. We view the move to a more principle-based approach, which then results in the effect of an entity's risk management activities more accurately being represented within its financial statements, as a positive development with the over-arching objective laying the foundation for this approach.

### **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 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. This increased flexibility allows an entity to more closely align its hedge accounting processes with its own risk management activities.

### **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 support the view that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item. The current restrictions within IAS 39, that prevent derivatives from qualifying as hedged items, are not aligned with the economic reality in some circumstances and, therefore, result in an entity not being able to match its hedge accounting with the objectives of its risk management measures.

### **Question 4**

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

We agree that 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 provided that the risk component is separately identifiable and reliably measurable. This proposal aligns the eligibility of risk components of non-financial items with that of financial items in IAS 39.





**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?***

We agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item as this will again allow an entity to align their accounting with their own risk management strategy.

We also agree with the view conveyed in BC 69 outlining that a layer of a contract that includes a prepayment option should not be eligible as hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk.

**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 with the hedge effectiveness requirements as a qualifying criterion for hedge accounting and support the Board's proposed removal of the 80-125 per cent 'bright line' effectiveness test. We believe that its replacement with an objective based assessment then creates a stronger link between hedge accounting and an entity's risk management processes. We are also in favour of the proposal to remove the retrospective hedge effectiveness testing as this will minimise the circumstances where a hedging relationship is de-designated as a result of market changes that cause the hedge to fail this retrospective test.

**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?***

We support the proposal that where the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship. The current IAS 39 approach where hedging relationships are discontinued when they do not meet the hedge effectiveness test is inflexible and does not reflect the economic reality in some circumstances. On this basis, assuming that the original risk management



objective remains unaltered, the adjustment to the hedging relationship should be treated as the continuation of the hedging relationship.

We also agree that an entity should be allowed to proactively rebalance the hedge relationship if it expects the relationship might fail the effectiveness test in the future, as such a policy is consistent with an active risk management approach.

We do, however, recognise that the concept of rebalancing is complex and requires substantial judgement. In light of this we would encourage the Board to provide more illustrative examples to outline how this may work in practice.

#### **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 believe the proposal 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 leads to a consistent approach within an entity's hedge accounting when compared with its risk management policies.

On the basis of the above we also agree that an entity should not be permitted to discontinue hedge accounting for a relationship that still meets the risk management objective and strategy.

#### **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 recognized 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***

Although we understand the reasoning behind these proposals we are unclear as to what additional information this provides to users of accounts. In essence the impact on profit or loss remains the same, although under these proposals there will be offsetting impacts within other comprehensive income that will still require explanation. However, we do 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 as it eliminates the mixed measurement issues currently experienced.

We also agree that linked presentation should not be allowed, but instead think that appropriate disclosures would be a better way of providing this information to users of accounts.

#### **Question 10**

***(a) Do you agree that for transaction related hedged items, the changes in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (e.g. like a basis adjustment if capitalized 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***

***(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?***

We agree with the Board's proposals in the area of transaction related hedges and period related hedges and support the view expressed within BC 148, although note that this will require preparers of accounts to analyse hedging processes, etc. in order to identify such items.

#### **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 with the criteria for the eligibility of groups of items as a hedged item and support the proposal to permit hedge accounting for net positions, as this again provides a hedge accounting process that is more aligned to the risk management process of an entity.

#### **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 agree with the Board's proposal that hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged item. As noted in BC 175 if there was instead a requirement to gross up all of the affected line items in the income statement it would result in the recognition of gross gains or losses that do not exist. We



would also add that the requirements in paragraph 38 are not consistent with this approach and will result in the presentation of the gross values within the statement of financial position.

**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 the proposed disclosure requirements will lead to greater transparency in relation to an entity's hedging activities. We would, however, encourage the Board to take stock at a suitable time in future to consider the wider disclosure requirements within IFRS. The current disclosure developments in recent exposure drafts are more onerous for preparers, with users of accounts faced with vast amounts of detail. We believe that there should be a review of corporate reporting disclosures in their entirety rather than on a standard by standard basis.

**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 with this proposal, as it is more in line with the way that entities may choose to manage their business and would provide more useful information to users of accounts.

**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?***

This issue is not of specific relevance to Tata Steel Europe Limited. However, on the basis the Board is driving at developing a standard that is principles rather than rules based, we agree with the approach outlined by the Board to not propose an alternative accounting treatment to account for hedges of credit risk using credit derivatives.



Page 8 of 8

**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 proposal that the application of this standard should be prospectively and support the transitional provisions that ensure current qualifying hedging relationships could be moved from the existing model to the proposed model from the adoption date.

In respect of the adoption date we would encourage the Board to consider a way of implementing all current developments within IFRS on a single adoption date to avoid the scenario of multiple years of corporate reporting being impacted by revisions to accounting standards.