

**Sent electronically through the IASB Website ([www.iasb.org](http://www.iasb.org))**

11 March 2011

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

Dear Sirs,

**IASB Exposure Draft  
“Hedge Accounting”**

We welcome the opportunity to respond to the Exposure Draft issued by IASB.

In general, we support the Board's proposal to develop a principle-based hedge accounting with the aim of providing a better link between an entity's risk management strategy, the rationale for hedging and the impact of hedging on financial statements.

We welcome the Board's efforts to reduce the complexity of hedge accounting and are supportive of the overall intent and direction of the proposal, although we have concerns in areas which mainly relate to disclosure requirements. Our comments to the specific questions set out in the Exposure Draft are included in the Appendix to the letter for your consideration. The following are the key areas which we urge the Board to consider making changes to the current Exposure Draft.

Eligibility of a group of items as the hedged item

We are generally supportive of the proposal as it allows hedging of groups of items including offsetting items and thus reduces the number of external derivative transactions required. However, we disagree with the restriction on cash flow hedges of offsetting hedged items, which require cash flows that affect profit and loss to be in the same reporting period. Due to this restriction, similar strategies may or may not be eligible for hedge accounting depending on the timing of the reporting. We believe hedging gains or losses should be determined when the hedged transaction occurs, not when it is reported in the accounts. Hence we suggest the Board consider a more principle-based rule which allows hedge accounting being consistently applied under similar risk management strategies.

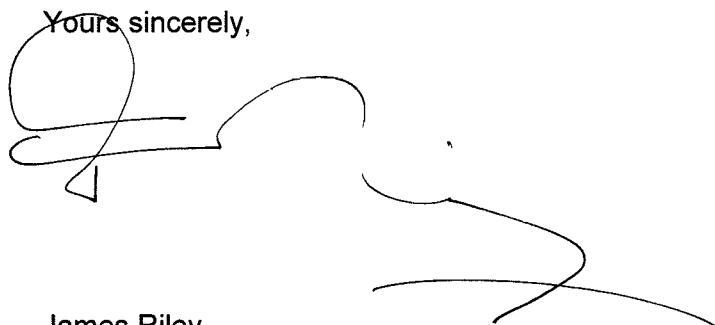
Disclosure and presentation requirements

Disclosure and presentation are essential to enhance the usefulness of financial statements when applying hedge accounting. While we agree many of the proposed presentation and disclosures are appropriate, certain requirements appear unclear or excessive, such as to present hedging results on a gross basis, and in the financial statements, to disclose exposure and forecasts for each subsequent period or to describe sources of hedge ineffectiveness affecting hedging relationships.

As users arguably always benefit from more information than less, we urge the Board to fine-tune the proposals with an aim to provide clear and useful information for decision making purpose.

If you have any questions on the content of this letter, please do not hesitate to contact me.

Yours sincerely,

A handwritten signature in black ink, consisting of a large loop followed by a series of connected strokes that extend to the right.

James Riley  
Group Finance Director

c.c. Hong Kong Institute of Certified Public Accountants

### **About the Jardine Matheson Group**

Founded as a trading company in China in 1832, Jardine Matheson is today a diversified business group focused principally on Asia. Its interests include Jardine Pacific, Jardine Motors, Jardine Lloyd Thompson, Hongkong Land, Dairy Farm, Mandarin Oriental, Jardine Cycle & Carriage and Astra. These companies are leaders in the fields of engineering and construction, transport services, insurance broking, property investment and development, retailing, restaurants, luxury hotels, motor vehicles and related activities, financial services, heavy equipment, mining and agribusiness. The Group had revenues (including the revenues of associates and joint ventures) of US\$47 billion in 2010 and total assets of US\$48 billion at the end of 2010. It employs some 300,000 people.

Jardine Matheson Holdings Limited is incorporated in Bermuda and has a premium listing on the London Stock Exchange, with secondary listings in Bermuda and Singapore.

Jardine Matheson is one of the pioneers in adopting International Financial Reporting Standards, having first prepared its financial statements in accordance with IFRS in 1990.

## **APPENDIX**

### **Comments on questions set out in the ED “Hedge Accounting”**

#### **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?

Agree. It is sensible to lay the foundation for a more principle-based rather than rule-based approach and it helps to align hedge accounting with an entity's risk management activities.

#### **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 with the proposed principle to permit non-derivative financial assets and liabilities measured at fair value through profit or loss to be designated as hedging instruments for the hedge of any risks including foreign currency risk. This increases corporates' flexibility in their financial risk management and hedge accounting will be better aligned with the entities' risk management strategies.

#### **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 welcome the proposal and agree with the Board's view that an aggregated exposure is created by including a derivative instrument, should not in itself, preclude designation of that aggregated exposure as a hedged item.

The proposal is in line with the objective to closely align hedge accounting with risk management strategies of entities.

#### 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 to be eligible for designation as hedged item, a risk component must be a separately identifiable financial or non-financial item and maybe contractually specified, and reliably measurable. The determination of appropriate risk components requires an evaluation of the relevant facts and circumstances.

#### 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 that a layer component of the nominal amount of an item is eligible for hedge accounting if such approach aligns with risk management activities.
- (b) We agree with the Board's view that if a prepayment option's fair value changes in response to the hedged risk, a layer approach is tantamount to identifying a risk component that is not separately identifiable. Hence, the layer component is not eligible as a hedged item in a fair value hedge.

#### 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 hedge effectiveness requirements, which are to meet the hedge effectiveness assessment and achieve other than accidental offsetting, as a qualifying criterion. We welcome the removal of the 80-125% hedge effectiveness test and the retrospective effectiveness assessment approach, which is currently required under IAS39, and believe the proposal promotes better alignment of hedge accounting with an entity's risk management strategy.

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 agree that entities should proactively rebalance the hedging relationship which fails or is expected to fail when meeting the objective of the hedge effectiveness assessment provided the original risk management objective remains unaltered.

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 agree that entities should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) cease to meet the qualifying criteria after taking into account any rebalancing.

We also agree to the Board's view that an entity should not be permitted to discontinue hedge accounting when risk management objective is still met, i.e. disallow voluntary discontinuation of hedge accounting in order to avoid arbitrary discontinuation by entities to achieve an intended outcome.

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?

- (a) We disagree with the proposal to present the gain or loss on the hedging instrument and the hedged item of a fair value hedge in other comprehensive income on a gross basis. We do not believe it provides additional information to users. We understand the Board's intention of this approach is to provide information on the effectiveness of an entity's risk management strategy. However, our view is that users can easily perform the assessment with reference to the level of ineffectiveness recognized in the profit or loss, combined with the relevant disclosures as proposed.
- (b) We agree that separately presenting the gain or loss on a hedged item will provide additional useful information to users, but we suggest presenting in the disclosure notes instead of in the primary financial statements to avoid excessive presentation of line items.
- (c) We agree that the linked presentation should not be allowed for fair value hedges.

Questions 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 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 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?

We consider the proposal to distinguish the time value of options between a transaction related and a time period related hedged item difficult to comprehend and apply in practice. We suggest the Board develop a more principal-based approach to apply the different accounting treatments.

#### 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 that an individual hedge approach and a group hedge approach are similar in concept, and consequently the eligibility criteria that apply to individual hedge items should also apply to hedges of groups of items. We also welcome the Board's proposal to permit a group of items that constitute a net position. These proposals bring the hedge accounting in line with the risk management strategy in practice.

However, we disagree with the restriction that cash flows of the offsetting hedged items in a cash flow hedge must affect profit and loss in the same reporting period. The hedging gain or loss is determined when the hedged transaction occurs, not when it is reported in profit and loss. The proposal adds complexity in practice as similar strategies maybe eligible for hedge accounting depending on the cut-off of the reporting period, especially for entities with quarterly reporting. This restriction is not consistent with the proposal for aligning with common risk management practices and hence defeats the purpose of allowing net position hedges. We suggest the Board consider a more principle-based rule which promotes consistent treatments for similar strategies.

#### 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 recognized 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 disagree to present hedging instrument gains or losses in a separate line from those affected by the hedged items as this unnecessarily introduces a large number of line items in the income statement. More importantly, the proposal to present net position hedges differently from hedges of gross positions is inconsistent with an objective to align hedge accounting with risk management activities. From a risk management perspective, it does not matter whether an offset is achieved through fair value changes of a hedging instrument or another hedged item.

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 an entity should provide information about its risk management strategy and how it is applied. We also agree that an entity should assess the effect of hedge accounting on the entity's financial statement. However, it is not convincing that all of the additional disclosure will effectively improve or enhance the transparency regarding an entity's hedging activities.

Certain proposed disclosure requirements appear to be unclear or excessive and may not provide useful information to users. For example,

- Para 46: To provide breakdown that discloses, for each subsequent period that the hedging relationship is expected to affect profit or loss. In particular, in quantitative terms, how hedging changes the exposure.

Disclosure of "how exposure profile changes after hedging" involves forward looking elements which may be judgmental and uncomparable with other entities. In addition, we find it unclear what "each subsequent period" refers to, and whether only aggregation of information for disclosure is required for entities with numerous transactions.

- Para 47 and 48: Disclose a description of the sources of hedging ineffectiveness that are expected to affect the hedging relationship during its term.

We agree that the source of hedge ineffectiveness should be included in the documentation of the respective hedge arrangement to facilitate the assessment of the effectiveness of respective risk management strategy. However, we doubt if the description disclosure provides useful 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 proposal to apply derivative accounting to commodity contracts held for the purpose of receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage. Hedge accounting does not necessarily provide appropriate accounting for the underlying hedging relationships.

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 commend and why?

No specific comment.

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 prospective application of the proposed hedged accounting requirements for all hedged relationships instead of only new hedged relationships, as it resolves the problem of having to apply two models simultaneously. Under this approach, some one-off transitional provisions will be allowed to ensure that "qualifying" hedging relationships can be moved from existing model to the proposed model and will therefore be subject to the proposed requirements from the adoption date.