Australian Government

Australian Accounting Standards Board

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03) 9617 7608

21 December 2012

Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Hans

IASB Review Draft on General Hedge Accounting

The AASB has asked me to write to you concerning the review draft of Chapter 6 of IFRS 9 *Financial Instruments* on general hedge accounting that was published on the IASB website on 7 September 2012.

In its response to ED/2010/3 *Hedge Accounting*, the AASB expressed its support for the objective of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement* in order to improve and simplify the accounting requirements for financial instruments and the IASB's decision to undertake a comprehensive review of the hedge accounting requirements to develop a more principles based approach that has the potential to provide more meaningful information.

The AASB wishes to highlight to you the significance to Australian constituents of the draft requirements in the IASB review draft standard on general hedge accounting. Overall the draft requirements are welcomed by constituents. However, some have concerns about the draft requirements in paragraph B6.5.5, which require that foreign currency basis risk is excluded from the measurement of the hedged item for the purpose of measuring hedge effectiveness of a hedging relationship that includes a cross-currency interest rate swap. Many are currently applying IAS 39 hedge accounting to these instruments and do not separately measure basis risk as ineffectiveness in these hedging relationships.

> **Measurement of hedge ineffectiveness**
>
> …
>
> B6.5.5 To calculate the change in the value of the hedged item for the purpose of measuring hedge ineffectiveness, an entity may use a derivative that would have terms that match the critical terms of the hedged item (this is commonly referred to as a 'hypothetical derivative'), and, for example for a hedge of a forecast transaction, would be at the money at the time of designation of the hedging relationship. This is one possible way of calculating the change in the value of the hedged item. The hypothetical derivative replicates the hedged item and hence results in the same outcome as if that change in value was determined by a different approach. Hence, using a 'hypothetical derivative' is not a method in its own right but a mathematical expedient that can only be used to calculate the value of the hedged item. Consequently, a 'hypothetical derivative' cannot be used to include features in the value of the hedged item that only exist in the hedging instrument (but not in the hedged item). An example is debt denominated in a foreign currency (irrespective of whether it is fixed rate or variable rate debt). When using a hypothetical derivative to calculate the change in the value of such debt or the present value of the cumulative change in its cash flows, the hypothetical

derivative cannot simply impute a charge for exchanging different currencies even though actual derivatives under which different currencies are exchanged might include such a charge (eg cross-currency interest rate swaps).

The constituents are concerned that these draft requirements:

- are inconsistent with one of the key objectives of the draft ie. to align hedge accounting with an entity's risk management;
- would significantly increase operational complexity for these types of hedging relationships; and
- would introduce additional inappropriate volatility to profit or loss arising from ineffectiveness from remeasurement of basis risk which would be unhelpful for the decision-making of users.

Accordingly the AASB encourages the IASB to further consider the draft requirements in this paragraph before the finalising the chapter of IFRS 9 on hedge accounting.

If you have any queries regarding any matters in this letter, please contact Sue Lightfoot (slightfoot@aasb.gov.au).

Yours sincerely

K.M. Stevenson

Kevin M. Stevenson
Chairman and CEO