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Dear Stig

Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Exposures Qualifying for Hedge Accounting

This letter sets out the Accounting Standards Board's (ASB's) comments on EFRAG's draft comment letter on the above Exposure Draft. The ASB agrees with EFRAG's support for the purpose of the proposed amendments but does not agree with EFRAG's suggestion that the IASB should specify the risks qualifying for hedge accounting in application guidance rather than a general amendment to IAS 39.

We welcome the IASB's initiative to clarify its original intentions regarding what can be designated as a hedged risk and when an entity may designate a portion of the cash flows of a financial instrument as a hedged item. The ASB recognises that the approach proposed in this exposure draft is rules rather than principle-based (paragraph BC13) and is concerned that this approach may lead to unintended consequences and prevent appropriate hedging accounting opportunities for items that should, in principle, be eligible.

Please refer to the Appendix to this letter for answers to the questions set out in the Invitation to Comment. If you wish us to expand on any aspect of this response, please contact me or Peter Godsall, p.godsall@frc-asb.org.uk.

Yours sincerely

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APPENDIX – Response to specific questions in IASB Exposure Draft of Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement – Exposures Qualifying for Hedge Accounting

Question 1 - Specifying the qualifying risks

The proposed amendments restrict the risks qualifying for designation as hedged risks to those identified in paragraph 80Y.

Do you agree with the proposal to restrict the risks that qualify for designation as hedged risks? If not, why? Are there any other risks that should be include in the list and why?

As stated in the covering letter the ASB is concerned that this approach may lead to unintended consequences for items that should, in principle, be eligible to qualify for hedge accounting and which may also result in preventing or discouraging new hedging opportunities. The Board is also concerned that the inclusion of the cash flows associated with a one-sided risk in the examples of "portions" paragraph 80Z (c)) implies that it is not possible to hedge a one-sided risk of the cash flows of a non-financial item.

It will be important that the IASB clearly states in the Basis for Conclusions the rationale for either the inclusion or omission of any other risks that are recommended by other respondents eg Equity price risk.

Question 2 – Specifying when an entity can designate a portion of the cash flows of a financial instrument as a hedged item.

The proposed amendments specify when an entity can designate a portion of the cash flows of a financial instrument as a hedged item.

Do you agree with the proposal to specify when an entity can designate a portion of the cash flows of a financial instrument as a hedged item? If you do not agree, why?

Are there any other situations in which an entity should be permitted to designate a portion of the cash flows of a financial instrument as a hedged item? If so, which situations and why?

Please refer to the response to Question 1.

Question 3 – Effect of the proposed amendments on existing practice

The aim of the proposed amendments is to clarify the Board's original intentions regarding what can be designated as a hedged item and in that way to prevent divergence in practice from arising.

Would the proposed amendments result in a significant change to existing practice? If so, what would those changes be?

As noted in our covering letter the ASB is concerned that the proposed rule-based approach to the amendments could result in a significant change to existing practice and notes EFRAG's comments in respect of the possibility to designate the time value of a hypothetical written option.

Question 4 – Transition

The proposed changes would be required to be applied retrospectively.

Is the requirement to apply the proposed changes retrospectively appropriate? If not, what do you propose and why?

The ASB supports the IASB proposal that the proposed changes should be required to be applied retrospectively and, as a consequence, supports option (a) in EFRAG's question to constituents. The ASB also agrees with the IASB that a requirement to restate comparative information on first time application of this proposed amendment should not entail significant cost or effort as the information required to make any restatement should be readily available.

Other EFRAG question to constituents:

Do you agree with EFRAG that the proposed guidance in AG99E is appropriate? If not, do you believe that hedge accounting provisions in IAS 39 should make it possible to designate option contracts in their entirety and designate time value of a hypothetical written option as part of the hedged item. Thus, when measuring hedge effectiveness and determining to which extent the hedge is effective, time value of a hypothetical written option would be included in estimation of changes in present value of cash flows of the hedged item attributable to the hedged one-sided risk? If so, how would you justify appropriateness of this method under IAS 39?

The ASB agrees with EFRAG's recommendation that the proposed guidance in AG99E is appropriate.