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April 25, 2011

Submitted electronically to [director@fasb.org](mailto:director@fasb.org)

Financial Accounting Standards Board,  
401 Merritt 7, PO Box 5116,  
Norwalk, CT 06856-5116

Attention: Technical Director

Dear Sirs:

**Re: Invitation to Comment, Selected Issues about Hedge Accounting, File Reference No. 2011-175**

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Invitation to Comment, *Selected Issues about Hedge Accounting*, issued on February 9, 2011. The views expressed in this letter take into account comments from AcSB members and staff but do not necessarily represent a common view of the AcSB. Views of the AcSB are developed only through due process.

We are not responding to the detailed questions posed in the Invitation to Comment. Comments made to the IASB in response to their Exposure Draft, *Hedge Accounting*, apply to these questions. A copy of our letter is attached for reference.

*Single global standard for financial instruments*

As expressed previously, we reiterate our belief that convergence between IFRS and US GAAP is very important to the efficient operation of international capital markets. Because all major Canadian financial institutions have significant operations in the US, convergence of financial instrument and hedge accounting standards is particularly important. In addition, our commodities-based industries need accounting standards that are the same as those applied by their suppliers, customers and closest competitors, many of whom are in the US. We are encouraged that the two Boards are considering alternative approaches to hedge accounting and hope that a single global standard for hedge accounting results.

We think that the IASB's proposal would address many of the practical problems with the hedge accounting provisions of IAS 39 and also of Topic 815. We agree that the qualifying conditions for hedge accounting in the existing standards are too strict and arbitrary. We think that it is more important to measure ineffectiveness in a hedging relationship properly and report it in net income immediately than to preclude a relationship from hedge accounting on the basis of a predetermined quantitative measure of correlation between the hedged and hedging components. We also agree that hedge accounting should not be discontinued on the basis of failing retrospective effectiveness tests.

We disagree with many of the details of the IASB's proposed standard. We are concerned that the model implies that hedge accounting is a necessary component of risk management, a term that is neither defined nor described. We think that hedge accounting is a complement to risk management; it represents exceptions to the normal application of accounting principles that should be focused on improving a financial statement user's understanding of a reporting entity's future cash flows. Exceptions should only be available if they can be applied in a rational and consistent manner when chosen.

#### *Comprehensive requirements for hedge accounting*

We think that any risk exposure should qualify for hedge accounting provided it is specifically identified and its effects are reliably measurable. A hedgable risk exposure could result from a single contract, a group of contracts or a component of a contract or group of contracts provided it meets the identification and measurement requirements. We think that the only necessary criterion for designating a hedging item in addition to those for a hedged item is that it achieves other than accidental offset with the designated hedged item. All other qualifying criteria are unnecessary because by identifying and measuring the hedged risk and the offsetting item, ineffectiveness is completely captured and there is no opportunity for manipulation.

We agree that the IASB's proposed guidance on hedging non-financial transactions and designating executory contracts as measured at fair value would be helpful to commodity-based entities. With further clarifications, the proposals would facilitate more consistent application to common management strategies for non-financial risks that we think should qualify for hedge accounting. We encourage the FASB to expand the scope of its proposals to include hedge accounting for non-financial risks.

The IASB's proposed model fails to address credit risk or inflation in an adequate manner. We think that hedge accounting for these risks should be permitted on the same basis as other risks, i.e., provided they can be specifically identified and their effects reliably measured. We think these criteria are essential to hedge accounting and that the same criteria should apply to qualify for hedge accounting for any risk. To optimize information provided to users, it is important that the hedge accounting model is comprehensive and consistent across all possible activities.

We note with interest that the IASB plans to develop a macro-hedging model. The proposed guidance on hedging groups of transactions would provide relief for some situations but we are uncertain

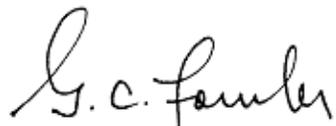
whether the proposed net position hedging guidance will be useful to financial institutions or commodity-based entities with high volumes of transactions. We agree that the hedge accounting project should not be delayed to accommodate development of macro-hedging proposals. We encourage FASB staff to work with IASB staff to determine whether a suitable model is feasible. If a viable macro-hedging model is developed, we think constituents should have the opportunity to re-evaluate the entire hedge accounting model.

We do not agree with the IASB's proposed requirement for mandatory rebalancing of hedging relationships or with the prohibition on discretionary discontinuance of hedge accounting. We think that it is important for a hedge accounting model to accommodate actual changes in hedge ratios without forcing de-designation and re-designation. We also think that the model should respond to changes in circumstances; the existing requirements for elective de-designation of hedging relationships should be maintained.

We do not think the IASB's proposals would necessarily reduce complexity for preparers. The proposed disclosure requirements are so onerous that some entities may forego hedge accounting if they perceive they are penalized through increased costs or by providing information that exceeds disclosures by peers who do not choose hedge accounting.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email [peter.martin@cica.ca](mailto:peter.martin@cica.ca)) or Kate Ward, Principal, Accounting Standards (+1 416 204-3437 or email [kate.ward@cica.ca](mailto:kate.ward@cica.ca)).

On behalf of the Board,

A handwritten signature in cursive script that reads "G. C. Fowler".

Gordon C. Fowler, FCA  
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APPENDIX – AcSB response to IASB on Exposure Draft, *Hedge Accounting*

March 9, 2011

International Accounting Standards Board  
30 Cannon Street, 1st Floor  
London EC4M 6XH  
United Kingdom

Dear Sirs:

**Re: Exposure Draft, Hedge Accounting, ED 2010/13**

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Exposure Draft, *Hedge Accounting*, issued on December 9, 2010.

The views expressed in this letter take into account comments from AcSB members and staff but do not necessarily represent a common view of the AcSB. Views of the AcSB are developed only through due process.

We commend the IASB on producing a proposed standard that addresses many of the practical problems with the hedge accounting provisions of IAS 39. We were also pleased that your staff has undertaken extensive outreach activities to foster understanding of the proposals and appreciated the opportunity to meet with them and a number of our stakeholders on their recent visit to Toronto. We hope the comments they received will be helpful in finalizing a new hedge accounting standard.

The AcSB agrees that hedge accounting is an important tool that can be used to facilitate communication of an entity's risk management activities to investors and other financial statement readers (users). However, we disagree that the objective of hedge accounting is to reflect an entity's financial risk management activities. We also disagree with the premise that users only care about an entity's risk management activities if the reporting entity chooses hedge accounting.

We are concerned that the proposals give greater precedence to the notion of matching than to other more fundamental concepts in the conceptual framework. If hedge accounting is optional, it represents sanctioned exceptions to well-reasoned principles to improve understanding of the reporting entity's future cash flows. Exceptions should only be available if they can be applied in a rational and consistent manner when elected.

We do not agree that implementing these proposals would reduce complexity for preparers. Many of the simplifications explained to us by your visiting staff are not evident in the words of the draft standard. We think that hedge accounting will not be chosen if the requirements are so onerous that

they penalize the reporting entity either through increased costs or by requiring disclosures that exceed those of peers who do not choose hedge accounting.

We understand the urgency of the project and the IASB's intention to resolve hedge accounting by June 2011. However, we think that the IASB will fail to produce a high quality standard if it insists on maintaining its planned project timeline. Hedge accounting is a complicated area. We think that the proposal is at least as complex as the existing hedge accounting standard and more difficult to understand due to many new and esoteric concepts. With the comment period spanning a major holiday in many jurisdictions and the calendar year-end reporting season, many stakeholders will have difficulty attaining sufficient understanding of the proposals to provide well-reasoned responses. We strongly encourage the IASB to carefully consider comments received on this Exposure Draft, to revise the proposal carefully and re-expose a simpler and more realistic model.

The Exposure Draft includes many proposals that could help entities communicate the effects of their risk management activities more clearly. However, the proposals in the Exposure Draft are incomplete without a macro-hedging model. In addition, the proposal would not permit hedge accounting for some common hedging strategies, including inflation and, in particular, credit risk. We encourage the IASB to take the time necessary to develop a comprehensive model for hedge accounting. Should a standard without provisions for these common hedging practices be issued in 2011, we think that the IASB should be amenable to revisiting the standard once they are published. Accordingly, we think that the effective date should allow at least 3 years for possible revisions to these provisions and to allow sufficient time for entities to revise systems and processes.

The AcSB is also extremely concerned that the IASB's rush to finalize this standard virtually rules out any possibility of arriving at a converged hedge accounting standard with the US Financial Accounting Standards Board (FASB). The FASB appears to be in no rush to finalize its comprehensive financial instruments standard; rather, it seems to be focusing on ensuring that it has a high quality standard and is prepared to take the time to ensure this result. We urge the Board to take the time necessary to determine whether a converged standard with the FASB is possible.

We have included in the Appendix our responses to the questions set out in the Exposure Draft.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email [peter.martin@cica.ca](mailto:peter.martin@cica.ca)) or Kate Ward, Principal, Accounting Standards (+1 416 204-3437 or email [kate.ward@cica.ca](mailto:kate.ward@cica.ca)).

On behalf of the Board

[signed]

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## **APPENDIX**

### ***Question 1***

We do not agree with the proposed objective because it presumes that hedge accounting is synonymous with risk management and will always be used by entities managing exposures from particular risks with financial instruments. If the objective of hedge accounting is 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, then, by definition, hedge accounting would have to be mandatory for all entities. The requirements of an optional standard will not ensure consistency or comparability among reporting entities. Mandatory requirements, most likely additional or reformatted disclosures, would be necessary to achieve the objective of representing the effect of an entity's risk management activities.

We think that hedge accounting is important because it is one way an entity might communicate the results of its activities to users. We also think it must be optional. We think the objective could be restated as "...at the option of the entity, to represent better the effect of risk management activities when an entity uses financial instruments to manages risk exposures". This type of statement would emphasize the optional nature of the requirements and their ability to improve upon normal accounting requirements.

We note that some constituents think that hedge accounting should be available for items measured at fair value with changes in fair value recognized in other comprehensive income. In many cases, the hedging activity reduces the entity's exposure to future cash flow variability but gains and losses on the hedging instrument would be recognized in profit and loss, hence generating a form of accounting mismatch.

We think that the terms "risk management strategy" and "risk management objective" should be defined in the standard because they are used throughout the proposed standard. Without clarification of their meaning, we think they could be applied opportunistically. For example, ambiguity about the term "risk management objective" could be interpreted to permit discretionary discontinuance of a hedging relationship.

### ***Question 2***

We agree that designating a non-derivative financial asset or financial liability as the hedging item could be appropriate in some relationships. We think that it would be useful to clarify that financial assets for which fair value measurement is elected could not be designated as hedging instruments because of the requirement that the elected measurement reduces or eliminates an accounting mismatch. We are unclear how the designation for a financial liability would work in coordination with the requirement to recognize changes in fair value resulting from changes in the instrument's credit risk in other

comprehensive income. We are also unclear whether the provision might apply to insurance liabilities because they are not in the scope of IFRS 9.

In spite of the restriction in paragraph B1, we think it might be possible to indirectly designate a derivative embedded in a cash instrument as a hedging instrument, thereby reversing the previous treatment of some complex financial assets. Although the entire instrument must be designated as the hedging instrument, we think it would be possible for the gain or loss on the embedded derivative to be recognized in other comprehensive income while the balance of the gain or loss on the host instrument is recognized in net income as ineffectiveness. This ineffectiveness would not interfere with the risk management objective or the objective of the effectiveness assessment because the gains and losses on the cash portion of the hybrid instrument would have no net effect over the life of the instrument.

Because of these concerns, we think that additional guidance needs to be provided to make this feature operational.

### **Question 3**

We agree that hedge accounting for scenarios that require more than one derivative to mitigate risks could provide better information for users. We think that the proposed treatment needs to be explained more clearly and illustrated in greater detail to prevent misapplication. It is not clear from reading the Exposure Draft whether:

- the derivative included in the aggregate exposure must be measured at fair value;
- both derivatives are designated as hedging items in sequence; or
- both hedging relationships need to be cash flow hedges.

It would be helpful to expand the examples in paragraph B9 to illustrate how this provision is intended to be applied.

We think that the term “aggregated exposure” should be defined; the word “exposure” is too imprecise. Ultimately, it is contracts or transactions that give rise to cash flows that expose the entity to economic risk. We think that it is necessary to describe the hedged “exposure” in sufficient detail so that any special accounting treatment cannot be adopted opportunistically. Alternatively, specifying that both elements of the aggregate exposure must qualify as a hedged item and hedging instrument, respectively, would provide this clarification.

### **Question 4**

We agree that an entity should be allowed to designate risk components of either financial or non-financial transactions provided the component is separately identifiable and reliably measurable. We think that this is a sufficiently strong test to prevent abuse when the component is contractually specified, such as the example in paragraph B15(a). We think that the standard should include additional guidance regarding the principles of “separately identifiable” and “reliably measurable” in the

context of both financial and non-financial instruments to ensure that the two concepts are appropriately and consistently interpreted.

We are unclear on the application of the proposal to components that are not contractually specified and think that many Canadian entities actively hedge such components. For example, a petroleum-based product may be priced based on a world benchmark such as WTI plus cracking spreads and transportation costs. Even though the individual components are not specified in a contract, we think that it is possible to hedge the benchmark component in this example. However, we do not understand how or why this example would differ from hedging the petroleum content in other products, in particular when that content is specified by a formula. It would be very helpful to include an example and explanation of a non-contractually specified component that would not be eligible for hedge accounting. We disagree with the statement in paragraph B18 that inflation cannot be hedged unless contractually specified. We also think that any hedge accounting model should accommodate credit risk hedging. Clarifying the general principle that risk components eligible for hedge accounting must be “separately identifiable” and “reliably measurable” should resolve any concerns about hedging a non-contractually specified inflation or credit risk component.

#### **Question 5**

We agree that the ability to designate specific portions of a hedged item gives considerably more flexibility than is possible in IAS 39 and, therefore, greater ability to align with a risk management program. We are not convinced that the distinction between risk components, layer components and percentage components is either helpful or a simplification. We think the interrelationship between these concepts should be illustrated more clearly.

We also think that any portion of a hedged item that is separately identifiable and reliably measurable should qualify for designation as a hedged item. These criteria seem to be missing from the requirements to designate “layer components”. If the term “layer” is intended to address only chronological events, then it is useful. This should be clarified by removing references to “bottom layer” because of similarity to terms used in securitization.

We agree that a prepayment option can be a source of significant ineffectiveness if there is no matching option in the hedging instrument. We are not convinced that the prohibition on designating a component with a prepayment option based on the sensitivity of the option to changes in the fair value of the hedged risk should be confined to hedges of portions of an item. We do not understand how prepayment risk is intended to factor into other hedging relationships. We do, however, think that prepayment risk can be reliably estimated for portfolios of financial assets and do not think that the restriction contained in the exposure draft should necessarily apply to hedges of a layer of a portfolio of prepayable financial assets. We suggest that this issue be dealt with either in this standard, or in the proposed subsequent standard on macro-hedging.

We disagree with the use of the word “nominal” in paragraph 18(c). We think it lacks the precision necessary for consistent interpretation. We do not see any definition of “nominal” that fits the use of

this word in this proposed standard either in use as an economic term or in common use. We think that more specific words should be used whenever possible to prevent confusion and interpretive difficulties.

### **Question 6**

We agree that the existing bright line test in IAS 39 is arbitrary. We also think that failing a preconceived correlation test should not change the accounting for contracts when the imperfections in offset (ineffectiveness) are recognized in profit or loss. We are encouraged by the statement that the proposals should align hedge accounting more closely with risk management. However, we are concerned that the objectives of ensuring unbiased results and minimizing ineffectiveness will not be interpreted as being less onerous than the bright line test. We also do not think that these objectives will be applied in a way that aligns with an entity's risk management in certain circumstances.

We think that "unbiased" and "minimize ineffectiveness" may be interpreted as meaning "highly correlated", and possibly applied more restrictively than existing requirements. We also think that some people interpret the criteria in paragraph B29 as permitting hedge accounting only for relationships that include a hedging instrument that is as close to perfect as possible. Our understanding of the requirements of paragraph B29 is that they are intended to prevent avoiding recognition of ineffectiveness in a cash flow hedge by underhedging. If this is the case, the proposal should be reworded to achieve the result directly without risk of misapplication to other scenarios.

Based on our discussions with your staff, we understand that applying the proposed standard involves the following steps:

- Determine the risk management objective and strategy;
- Choose a hedging instrument that meets the objective and strategy taking into account availability, costs to administer, counterparty risks, etc;
- Determine that the hedged item and the hedging instrument meet the criteria in the proposed standard;
- Determine whether the offset between the chosen hedging instrument and the hedged item is other than accidental, i.e., determine that there is an economic relationship between the hedged item and the hedging instrument such that there is an expectation of offset;
- Choose a hedge ratio that minimizes ineffectiveness, i.e., given the hedged item and the hedging instrument chosen by the entity, there is no other hedge ratio that is expected to produce less ineffectiveness.

If we are correct in our interpretation, the criterion in paragraph 19(c)(i) and paragraph B29 should be eliminated; the limiting criterion is whether the offset between the two items is other than accidental. We think that this should be the only qualifying criterion to achieve hedge accounting. All other aspects of a hedging relationship should be determined by the entity's risk managers, including the appropriate hedge ratio that achieves management's risk management objective for the specific hedging

relationship. Any ineffectiveness in a hedging relationship should be recognized immediately in net income.

If our recommendation in the preceding paragraph is rejected, we think that the qualifying criteria for hedge accounting should be stated in the body of the standard, rather than in Appendix B. Although we disagree that meeting the “objective of the hedge effectiveness assessment” should be a condition for achieving hedge accounting, we think that defining the term in paragraph B29 would lead to confusion and misinterpretation.

#### **Question 7**

We acknowledge that it is often necessary to restructure hedging relationships and agree that the standard should permit rebalancing. We also agree that IAS 39 is very cumbersome in requiring dedesignation and redesignation in equivalent circumstances, and note that the redesignated hedging relationship often fails the quantitative effectiveness criteria required by IAS 39. Therefore, the rebalancing proposals are an improvement. However, we do not agree that an accounting standard can or should force rebalancing; this is inconsistent with a business model approach to ineffectiveness. Rebalancing should result only when the entity’s risk managers take action to change one or more components of a hedging relationship.

Rebalancing is also inconsistent with the prohibition on discretionary discontinuance because failure to rebalance could be indicative that the relationship no longer meets the effectiveness objective.

In summary, we disagree with the requirement to rebalance hedging relationships solely for accounting purposes. We think that rebalancing should be permitted but that failure to rebalance should not be linked to any notion of an effectiveness objective. This should be replaced by a comment that failure to rebalance increases ineffectiveness and, therefore, income volatility.

#### **Question 8**

We disagree that discontinuance should be limited to failure to meet the qualifying criteria. Dedesignation or discontinuance is necessary to reflect changes in business conditions such as the development or acquisition of a natural hedge. We do not agree that discontinuance should be linked to an entity’s assertions of risk management objectives and strategies; these can be changed.

We also note that the distinction between risk management objectives and risk management strategies is not made clearly in the proposal. Because the exposure draft proposes that this distinction affects whether a hedging relationship is discontinued, we think the proposed guidance should be clarified. An illustrative example would also be helpful.

#### **Question 9**

We have divided views on this issue.

We disagree with the proposal to modify fair value hedge accounting by requiring the measurement adjustment of the hedged item to be presented as a separate line item in the statement of financial position. This treatment fails to simplify hedge accounting, results in balances reported in the balance sheet that do not meet the definition of an asset or a liability and perpetuates measurements that are neither fair value nor amortized cost. We prefer treating fair value hedges in the same way as cash flow hedges as a simplification, even though it does not remove the complexity of calculating ineffectiveness.

Some of us think that the distinction between fair value and cash flow hedges is arbitrary and artificial; the objective of hedging is always to modify cash flows. This distinction is an artificial construct invented by accountants for accountants; it has no equivalent concept in risk management. These individuals disagree with the proposal to modify fair value hedge accounting by requiring the measurement adjustment of the hedged item to be presented as a separate line item in the statement of financial position. This treatment fails to simplify hedge accounting, results in balances reported in the balance sheet that do not meet the definition of an asset or a liability and perpetuates measurements that are neither fair value nor amortized cost. These individuals think that fair value hedges should be treated in the same way as cash flow hedges, as a simplification, even though it does not remove the complexity of calculating ineffectiveness.

Others agree with comments in the exposure draft that the cash flow hedging model applied to fixed rate debt instruments and firm commitments produces unnecessary and artificial volatility in equity. They observe that some users, including prudential regulators, attach significant importance to the measurement of equity.

We also note that many constituents complain that use of other comprehensive income increases accounting complexity. We are concerned that accounting standards increasingly require use of other comprehensive income on the basis of unpopularity of an item as a component of profit and loss, rather than based on application of a principle. Some of these constituents do not support the proposal that changes in the hedged risk and changes in the hedging instrument in a fair value hedge be recorded in other comprehensive income. Despite these concerns, we think that the best single model for hedge accounting would involve deferral of the effective portion of gains or losses on the hedging instrument in other comprehensive income for all hedging relationships.

We are also concerned that the proposal does not provide a mechanism for reporting the measurement adjustments in a way that clearly ties them to the hedged item. If reported on a separate line in the balance sheet, the fair value related to the hedged item should be clearly reported as an adjustment of the asset or liability to which it relates to avoid the appearance of reporting balances that do not meet the definition of an asset or a liability. This could be accomplished if reported in the same manner as an allowance for doubtful accounts. We do not agree that separate line reporting in the balance sheet is necessary; adequate information could be provided in the notes.

We disagree strongly with describing accumulated other comprehensive income associated with cash flow hedges as a cash flow hedge reserve. Reserve accounting was eliminated many years ago to

prevent accounting practices that stretched the concept of matching to the point of abuse. It should not be resurrected.

We do not agree with the notion of linked presentation. It does not improve understanding of the risks associated with the hedged item and it interferes with the ability to identify and analyze the reporting entity's assets and liabilities.

#### **Question 10**

Although reluctant to endorse further use of other comprehensive income, we agree with the proposal in the exposure draft related to time period related hedged items that the time value of the premium on purchased options should be treated in the same manner as an insurance premium; changes in the fair value of the time value of the option should be recognized in other comprehensive income with the original time value amortized to profit and loss over the term of the hedge. However, we do not agree with the proposed "transaction related" approach; we think that the option premium should be recognized over the protection period in all cases. We also disagree that requiring the time value to be capitalized to the hedged item is a simplification, as we understand that this requirement will require significant systems modifications for many preparers.

We do not agree that the proposed use of other comprehensive income should be mandatory. In many cases, recognizing changes in the fair value of the time value of an option directly in profit or loss will be simpler than recycling the balance out of other comprehensive income and the difference in net income between the two methods will not differ materially.

Conceptually, we agree with the "aligned time value" concept. However, we are concerned that this concept will be difficult to implement without allowing allocation on a basis other than through use of an option pricing model as a practical expedient.

#### **Question 11**

We agree that the standard should permit hedging groups of items. We are not sure whether the proposed application to net positions will be helpful or practical. The proposal is incomplete without guidance on macro-hedging. We understand the sensitivity to completing a standard by June 2011 and that incorporating provisions for macro-hedging is not possible in that timeframe. To ensure a complete and comprehensive hedge accounting standard is ultimately available, we think that:

- the IASB should be amenable to revising the standard resulting from this exposure draft; and
- the effective date for this initial portion of a complete standard should be sufficiently long to allow reporting entities to avoid piecemeal implementation.

**Question 12**

We agree that this proposed presentation would be helpful to financial statement users. We also agree with the statement in paragraph IN39 that grossing up the gains or losses on the hedging instrument would constitute recognition of offsetting gains and losses that do not exist. However, we are unclear as to how a fair value hedge of a net position will work, especially if the offsetting hedged items are recognized in profit and loss in different periods, as contemplated in paragraph B74. This would appear to require grossing up of the gains or losses on the hedging instrument in order to be able to recognize the appropriate hedging adjustment for each of the hedged items.

**Question 13**

We think that the disclosure requirements will be considered extremely onerous by financial statement preparers, possibly to the extent of deterring entities from electing to use hedge accounting. While the required information could be very informative, the presumption that entities will want to apply hedge accounting and disclose this information is flawed. In particular, the disclosures proposed in paragraph 46 about amounts or volumes to which the entity is exposed and the amount of that exposure that is hedged could require disclosure of commercially sensitive information. As these disclosures are only required when hedge accounting is elected, we are concerned that they will be perceived as a penalty to entities wanting to apply hedge accounting. The disclosures for hedge accounting should be limited to explaining the effect of applying hedge accounting.

**Question 14**

We agree with providing a fair value option for contracts for the purchase or sale of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. The expected use exemption prevents commodity-based businesses from reflecting the economic effect of their exposures to commodity prices fully. However, we do not agree that this option should be restricted to contracts that can be settled net in cash nor do we agree that the option should be restricted to entities that manage non-financial contracts on a fair value basis. Entities do not distinguish between contracts that can be settled net in cash and those that must be settled physically when managing price risk.

**Question 15**

We do not support any of the alternative approaches described. We think that the ability to hedge credit risk should be subject to requirements for hedging other risk components. Each of the alternatives presented in the Basis for Conclusions would permit an accounting treatment that would not be available to relationships that are more likely to qualify for hedge accounting. We also agree that all of them would add unnecessary complexity. This issue appears to arise from the accounting mismatch between recognizing changes in the fair value of a credit derivative in profit and loss and recognizing impairment of the hedged financial asset. Accordingly, we think that hedging credit risk has implications for the IASB's project on impairment of financial assets and should also be considered in connection with that project.

We think that hedging credit risk is a form of hedging a specific risk component, and should meet the same criteria as other hedging relationships. As noted in our response to Question 4, we think that additional guidance on the application of “separately identifiable” and “reliably measurable” in the context of both financial and non-financial instruments should be provided to ensure that the two concepts are interpreted appropriately and consistently. This additional guidance should be specific enough to enable entities to determine whether credit hedging with credit derivatives can be achieved.

**Question 16**

We are concerned that a January 1, 2013 effective date may not provide adequate lead time for many entities wishing to use hedge accounting. As noted above, the exposure draft proposals are incomplete without a model for macro-hedging. Entities will need adequate time to evaluate the entire set of provisions and modify their systems to apply the new requirements. We do not think this will be possible by January 1, 2013.

We think that an entity should be able to apply the standard before its effective date provided it has implemented IFRS 9. Many of the proposed changes will be very helpful to entities that are unable to achieve hedge accounting with IAS 39

We also think that additional guidance would be helpful to explain the transition for continuing hedging relationships.