Hong Kong Institute of
Certified Public Accountants
香港會計師公會

Our Ref.: C/FRSC

Sent electronically through the IASB Website (www.iasb.org)

14 January 2008

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

Dear Sirs,

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

The Hong Kong Institute of CPAs is the only body authorised by law to promulgate financial reporting, auditing and ethical standards for professional accountants in Hong Kong. We welcome the opportunity to provide you with our comments on the captioned Exposure Draft. Our responses to the questions raised in your Exposure Draft are set out in the Appendix for your consideration.

We support the IASB's initiative to clarify the areas of risks that are eligible for hedge accounting and the portion of the cash flows that can be designated as a hedged item under IAS 39 *Financial Instruments: Recognition and Measurement*. We recognise that hedge accounting in IAS 39 is more rules-driven than principles-based and as the amendments' objective is to provide clarity in identifying a qualifying hedge accounting relationship, we accept the necessity for a short-term rules-based approach. However, we believe that, in the long term, the IASB should develop principles-based standards for financial instruments.

If you have any questions on our comments, please do not hesitate to contact me at patricia@hkicpa.org.hk.

Yours sincerely,

Patricia McBride
Executive Director

PM/WC/ac

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓

Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603

Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

APPENDIX

Hong Kong Institute of CPAs

Comments on the IASB Exposure Draft
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 included in the list and why?

We consider that the risks specified in the amendments are those risks that are commonly designated as hedged items in practice. However, we are concerned that it is not clear whether some of the less commonly hedged risks such as commodity price risk and equity price risk would still qualify for hedge accounting.

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?

We agree that the portions specified in the amendments are those most commonly designated as hedged items.

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 explained further below, we consider that the amendments may change existing practice significantly where options are used as hedging instruments. The amendments may also impact on hedge accounting in respect of non-financial items, depending on how their relevance to paragraph 82 is interpreted.

The exposure draft includes an exception to the existing principles regarding hedge accounting, by disallowing the use of the hypothetical derivative approach for hedges of a one-sided risk, notwithstanding that measurement of the fair value change of cash flows attributable to a one-sided risk (i.e. fair value changes in the hedged item for the hedged risk) would exactly match the fair value change of a hypothetical option. We do not support this exception.

Furthermore, the exposure draft includes a one-sided risk as a "portion" in paragraph 80Z, which would seem to eliminate an entity's ability to hedge account for options over commodities (even using intrinsic value) since according to paragraph 82 a "portion" of a non-financial instrument may not be designated as the hedged item (other than for foreign currency risk). If interpreted in this way, this would also represent a significant change to existing practice. We would support clarifying the extent to which cash flow risks in a non-financial item may be hedged by broadening the portions of non-financial instruments which may be designated as hedged items to include those where the relevant portion is contractually specified and reliably measurable, as the rationale given originally for disallowing the hedging of portions (not being reliably measurable) is outdated: many portions of non-financial instruments are easily measurable, often by way of a quoted price in an active market.

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?

We do not support the retrospective application of this amendment. We believe that amounts previously deferred in equity should continue to be carried forward and transferred to profit or loss when the hedged transaction affects profit or loss. It will often not be practicable to apply this amendment retrospectively. For example, where the entity's accounting policy is to make a basis adjustment in a cash flow hedge and inventory is measured on a weighted average basis, recreating historical inventory data from first application of IAS 39 to date would, even if possible, give rise to undue cost and effort.