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OFFICE OF DIRECTOR FINANCE

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International Accounting Standards Board
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Mr Keith Alfredson
Chairman
Australian Accounting Standards Board
PO Box 204
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Dear IASB

IASB ED 'Proposed amendments to IAS 32 ' Financial Instrument: Disclosure and Presentation' and IAS 39 'Financial Instruments: Recognition and Measurement'

General Comments

Telstra does not speculate but uses derivatives to hedge underlying positions to obtain a set benchmark position, which has been set to minimise the economic impact of volatility in foreign exchange rates or interest rates on the Companies financial position. In taking this approach, we believe that the underlying objective of accounting should be to require hedging results to be combined with the result of the underlying exposure in such a way that the true net economic position is disclosed.

In our compliance with the requirements of SFAS 133 we have found it has created problems in doing this sensibly in the following areas:

1. Hedging of interest rate risk on commercial paper issues (ie. short term debt)

Telstra manages on a Net Debt portfolio basis from which is derived a residual interest rate risk. This risk is then managed by the application of standard derivative products to meet a benchmark position.

Part of the debt raising undertaken by Telstra is to issue commercial paper (ie. short term borrowings). At times, we can have a large amount of our debt portfolio funded this way and to meet the benchmark position, we may need to enter into derivatives which hedge the interest rate risk back to a fixed proportion. The mark-to-market impact of these derivatives should be passed back to the underlying commercial paper issues, as this is the hedge being applied to meet the benchmark position and not taken to P&L as proposed in the standard.

2. **Dynamic hedging of interest rate risk associated with long term debt raisings**

As outlined above, Telstra manages on a Net Debt basis and this means that the hedging of interest rate risk needs to be dynamic as cash flows from the underlying business of Telstra move our Net Debt position. This dynamic hedging is primarily achieved by using A$ Interest Rate Swaps to move the fixed / variable ratio back to a benchmark position.

The debt portfolio is made up of large foreign currency borrowings which have been swapped back to A$ (local currency) using cross currency swaps. It may then occur that these swaps, or part of them, is swapped back to fixed rate A$ using interest rate swaps. Then, going forward as the mix of debt changes, to maintain the benchmark position, we may need to move this back to floating rate debt, as so on. The problem here is that under SFAS 133, the basic rule is that you cannot "have a hedge of a hedge" and therefore under our dynamic hedging scenario all subsequent derivatives are marked-to-market and movements taken to profit / loss. In our terms, this is not a hedge of a hedge but is the dynamic management of an underlying position and the standard should allow for this.

3. Hedging of interest rate risk on foreign currency loans

An issue arises as a result of the need to hedge the foreign exchange and interest rate risks associated with foreign currency loans. The risks back to A$ are hedged using foreign currency forwards currently, but this could be a combination of these derivatives and outright borrowings in the foreign currency. Where FX forwards are used, the foreign currency component is marked to market on both sides of the transactions, ie. the loan and the hedge. However, the interest rate risk imbedded in the foreign currency loan is not marked to market and therefore a mismatch occurs as we have the market value of the derivative but not the underlying exposure.

Not only have the above problem areas led to unhelpful accounting presentation (ie. not conveying the true net economic position) but in some instances resulted in us hedging in a less efficient manner or even possibly not hedging at all to avoid the technical problems associated with accounting.

We request that the IAS recognise these issues and amend the new standard accordingly.

Some Specific Comments

IAS32

Our initial review of the disclosure and reporting requirements contained in this standard indicate that as it basically follows the requirements of AASB 1033 'Presentation and Disclosure of Financial Instruments' we have no major issues with this standard.

IAS39

From our initial reading of the requirements outlined, we make the following observations:

The calculation of fair value appears consistent with SFAS 133 and we are comfortable with this and have no issues in implementation of IAS 39.

There appears to be a choice between taking the results of fair value hedges to balance sheet or profit/loss, which appears strange. We may have misread or not interpreted correctly the intent of the standard in this regard; clarification on this aspect is recommended.

The document suggests that loans held to maturity are outside scope. If we are therefore hedging such an instrument with a derivative this will cause an unbalanced position to be reported, as we would be marking-to-market the derivative and not the corresponding underlying exposures which are being directly hedged.

In terms of derecognition, our interpretation is that the provisions envisaged will make it harder to achieve off balance sheet structures and the provisions would not be grandfathered. We would support grandfathering of transactions with the appropriate disclosure.

We thank you for the opportunity of being able to comment on such an important change to accounting on a global basis. Please contact Garth Campbell-Cowan on +61(3) 9634 6470 if you need any further explanation on any of the comments made in this submission.

Yours sincerely

John Stanhope
Director Finance