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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
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8 October 2004

Dear Sir David

Exposure Draft of Proposed Amendments to IAS 39, Cash Flow Hedge Accounting of Forecast Intragroup Transactions

We are responding to your invitation to comment on the above exposure draft on behalf of the worldwide organisation and Global IFRS Board of PricewaterhouseCoopers.

We share the concerns of constituents set out in BC 4 to the exposure draft. We recognise the need for the IASB to address the issue of cash flow hedge accounting of forecast intragroup transactions following the deletion of IGC 137-14. The removal of the right to hedge account for such transactions constituted a major change in IAS 39 (revised 2003). This change has a significant impact for many multi-national corporations which hedge their exposure to cash flow variability arising from forecast intragroup transactions between entities with different functional currencies. We are pleased that the Board has recognised the importance of this issue and the need to find a quick and simple solution.

Nevertheless, we do not support the proposed solution in the exposure draft as it permits cash flow hedge accounting in many circumstances which are inconsistent with the underlying concepts. Cash flow hedge accounting is the hedge of an economic exposure, which arises when an entity forecasts a transaction denominated in a currency other than its own functional currency and could affect profit or loss. It should not be extended to cover accounting exposures arising as a result of the selection of the group's presentation currency. The arguments in BC 14 are based on the premise that the group's presentation currency would be its functional currency if it were a single entity. This is inconsistent with IAS 21 which requires the separate identification of the functional currency of each individual entity in the group and permits any currency to be selected as presentation currency.

The exposure draft creates a new form of hedging, profit and loss translation hedging, which is not allowed under IAS 39 (revised 2003) or US GAAP. This change has broader implications beyond the specific issue that the exposure draft is addressing and, if appropriate, should be the subject of a separate debate.

The Board should extend the scope of paragraph 80 of IAS 39 to permit the designation of an intragroup forecast transaction as a hedged item for foreign currency risk in a cash flow hedge in consolidated financial statements. Such an approach would be consistent with paragraph 36 of FAS 133 and ensure convergence with US GAAP.

We do not propose the reintroduction of the requirement in IGC 137-14 that an intragroup transaction results in the recognition of an intragroup monetary item for which exchange differences are not fully eliminated on consolidation, as proposed in BC5(a). The hedged risk is the variability in cash flows arising from foreign currency movements since the hedge is designated. This economic exposure is not represented by the foreign currency gain or loss on the intragroup monetary item which arises only from the date at which the transaction is reflected in the accounts. The requirement in IGC 137-14 does not create any additional economic exposure but imposes an artificial requirement on groups to ensure that there is sufficient time between the accounting recognition of the transaction and the transfer of cash flows for an intragroup monetary item to arise.

Question 1

Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

We do not agree with the proposals in the Exposure Draft. The proposed amendment does not address the topic of cash flow hedge accounting of forecast intragroup transactions set out in its title. Instead, the Exposure Draft proposes that a forecast external transaction by a subsidiary in its own functional currency can be designated as a hedged item, provided that it gives rise to an exposure when remeasured in the group's presentation currency. Such transactions do not result in any exposure to variability in cash flows, a prerequisite for cash flow hedge accounting under paragraph 86(b) of IAS 39.

IAS 21, *The effects of changes in foreign exchange rates,* recognises that an economic exposure exists when a transaction is denominated in a currency other than the functional currency of the entity entering into the transaction and thus requires any resulting exchange gain or loss to be recognised in the profit or loss account. The selection of an entity's functional currency is not a matter of choice but rather reflects the economic conditions in which the entity operates. Permitting the use of cash flow hedging at the individual entity level recognises the economic exposure that results from the decision to enter into a transaction in a currency other than its functional currency. Paragraph 38 and 39 of IAS 21 state that the selection of a group presentation currency is required for groups, which consist of entities with different functional currencies, to produce consolidated financial statements and translation differences resulting from accounting exposure are reflected in equity. The Exposure Draft confuses the two concepts and permits profit and loss translation hedging, which is the hedge of an accounting risk comparable to net investment hedging.

Paragraph 38 of IAS 21 allows an entity to present its financial statements in more than one presentation currency. The exposure draft does not cover the case where an entity elects more than one presentation currency. In the example in BC2, if the consolidated financial statements of group A were presented in both EUR and USD (i.e. the group prepares two separate sets of consolidated financial statements), cash flow hedge accounting could only be applied in the financial statements presented in EUR.

As discussed above, we recommend that intragroup forecast transactions should be eligible for cash flow hedge accounting on consolidation provided (1) the criteria for hedge accounting are met (IAS 39.88) and (2) there is an intragroup transaction between group entities with different functional currency. This permits entities to hedge the economic exposure and profit and loss impact based on the different functional currencies within the group.

Question 2

Do the proposals contained in Exposure Draft appropriately address the concerns set out in paragraph 3 of the Background on this Exposure Draft? If not, why not, and how would you address these concerns?

We do not consider that the proposals contained in the Exposure Draft appropriately address the highlighted concerns. We recognise that many groups, including existing IFRS reporters, have an established practice of hedging forecast intragroup transactions. The deletion of IGC 137-14 has eliminated their ability to designate these transactions as hedged items in a cash flow hedge.

The proposed guidance in paragraph AG 99A permits the designation of external items as cash flow hedges in many circumstances where an economic exposure does not exist. In the circumstances described in BC 2, the group is permitted to hedge the forecast external sales in the US dollar, even when company C has no US dollar currency exposure, when the group has a Euro presentation currency. However, in this case there would be no economic exposure to cash flow variability within the group.

Paragraph AG 99A permits a reporting entity to hedge against its presentation currency. We are aware of entities which choose their local currency for presentation purposes, frequently in accordance with local regulatory requirements, even though this is not the functional currency of the majority of entities in the group. The proposals in the Exposure Draft permit a group to hedge any forecast external transactions against movements in the presentation currency, even where the presentation currency has no relevance to its operations. Such hedging will eliminate the accounting variability that would otherwise appear in its consolidated profit or loss. Such a hedging transaction will economically expose the group to a foreign currency risk that should be recognised as a trading transaction in the group income statement.

We also note that the Exposure Draft does not facilitate convergence with US GAAP where a highly probable forecast intragroup transaction in a currency other than the company's functional currency may be the hedged item. The Exposure Draft proposes that a highly probable forecast external transaction in the entity's own functional currency is the hedged item. Under US GAAP cash flow hedge accounting can be applied only if there is an economic exposure (i.e. the hedged transaction is denominated in a currency other than the functional currency of the entity entering into the transaction) whereas the Exposure Draft does not require such an exposure to exist.

In addition, US GAAP requires the release of the amounts accumulated in equity to the income statement to occur when the related external transaction impacts the income statement. We believe such a requirement should be introduced into IFRS.

Question 3

Do you have any other comments on the proposal?

The Exposure Draft is an amendment to IAS 39 (Revised 2003) requiring retrospective application. In accordance with paragraph 88 and IG F.3.8, hedge accounting is only applied prospectively from the date of designation and documentation. Therefore, an existing IFRS preparer with intragroup transaction hedges that comply with IGC 137-14 will have to restate its 2004 financial statements to reverse the hedge accounting obtained under the previous standard.

Accordingly, the transition provisions in the Exposure Draft should be amended to require prospective application of the amendments from the date of adoption. This will permit existing IFRS preparers to achieve hedge accounting in their comparative financial statements and to redesignate or terminate their existing hedges prior to adoption.

Paragraph AG 99A of the Exposure Draft states that a group can designate as the hedged item, in a foreign currency cash flow hedge, a highly probable forecast external transaction denominated in the functional currency of the entity (e.g. subsidiary) entering into the transaction. The reference to a subsidiary as an example of an entity suggests that a highly probable forecast external transaction denominated in the functional currency of a joint venture or associate could be designated as the hedged item in a foreign currency cash flow hedge. Per paragraph 4 of IAS 27, *Consolidated and separate financial statements*, a group is defined as a parent and all its subsidiaries. Therefore, we believe the reference to an entity above should be defined as only a parent company or a subsidiary.

If you have any questions in relation to this letter please do not hesitate to contact Jochen Pape, Chair of the PwC Global IFRS Board (+49 211 981 2905), or Ian D Wright (+44 207 804 3300).

Yours faithfully

PricewaterhouseCoopers LLP