International Accounting Standards Board
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Exposure Draft of a Proposed Amendment to IAS 39 Financial Instruments: Recognition and Measurement, Cash Flow Hedge Accounting of Forecast Intragroup Transactions

FAR, the institute for the accountancy profession in Sweden, is responding to your invitation to comment on the Exposure Draft of a *Proposed Amendment to IAS 39 Financial Instruments: Recognition and Measurement, Cash Flow Hedge Accounting of Forecast Intragroup Transactions*.

General comments

We do not agree with the proposals in the Exposure Draft. The proposals are consistent with the hedge rules in IAS 39, but we believe that IAS 39 should be amended to allow for cash flow hedging of highly probable forecast intragroup transactions. We believe that group level hedges of intragroup transactions should be accepted since hedges of foreign exchange gains and losses on intragroup monetary items are accepted as hedged items. Otherwise, to be consistent, hedges of intragroup monetary items should be prohibited.

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. We consider the proposal to be too limited in scope and would prefer IAS 39 to be amended to allow cash flow hedges of forecast intragroup transactions. However, if such amendments would not be feasible in a short term perspective, it should be clarified that in the consolidated financial statements a group can designate as the hedged item an external firm *commitment* in the functional currency of the entity entering into the transaction. Further, it should be clarified that the entity entering into the hedge transaction may be a foreign operating unit of the reporting entity preparing the consolidated financial statement (and not necessarily a subsidiary). We suggest the following reading: In consolidated financial statements a group can designate as the hedged item an *unrecognised external firm commitment* or a highly probable forecast external transaction denominated in the functional currency of the entity (e.g. subsidiary or branch) entering into the transaction, or in another currency than the entity´s functional currency, provided the transaction gives rise to an exposure that will have an effect on consolidated profit or loss (*i.e. is denominated in a currency other than the group's presentation currency*).

The proposal also demonstrates the shortcomings in IAS 21 and the inconsistency between IAS21 and IAS27 in the consolidation process. IFRSs are built on the guiding principle that the consolidated financial statements purport to present the group as a single economic entity. In that perspective it should not be at all possible to hedge intragroup items. Rather, the decisive question is if the single-economic-entity-perspective should take precedence over the fact that consolidation conventions give rise to translation effects, or vice versa. This apparent inconsistency could be solved by revoking the current exception in IAS 39 paragraph 80 *or* allowing forecasted intragroup transactions as hedged items. We prefer the latter, at least in the short-term perspective.

We note that within the Board there are different views on what constitute currency risk (BC12-B14). The approach in BC12 builds on the notion that only an operating unit[1] can have a functional currency. Thus, only operating units can have a currency exposure and not a group. We believe that such a strict bottom-up approach should be rejected.

It should be clarified whether a single economic entity can have only one functional currency, as stated and illustrated in paragraph BC 14, since an entity may consist of several independent sub-entities (like branches with different functional currencies). A clarification would be desired, both in IAS 21 and IAS 39. The present definition of a foreign operation in IAS 21 p. 8 may be interpreted as based only on legal entities. We believe that the definition should also include some operational units like segments. Such change would furthermore converge to US GAAP, where FAS 52 contains the notion that an operating unit rather than a legal entity has a functional currency.

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 believe that the concerns set out in paragraph 3 are properly addressed in the Exposure Draft. We are concerned that the proposal will require re-engineering of current hedging strategies for purchases of inventory that is resold within the group A forecasted external purchase may be designated as a hedged item. Likewise an intra-group payable or receivable may be designated as a hedged item. Nevertheless, there will be a time window between external purchase of the inventory and the intra-group reselling thereof. During that period of time the group may designate the inventory as a hedged item in a fair value hedge. Although that is theoretically possible it is highly impractical. We therefore believe that highly probable forecasted intra-group transactions should be eligible as hedged item.

Question 3

Do you have any other comments on the proposals?

We believe that the Basis for Conclusion should elaborate in depth on the coherence between the concepts of functional currency, presentation currency, embedded currency derivatives (that is not clearly and closely related) and hedging of currency risk. Also, it is important to be clear on if different conclusions are warranted for different financial statements (e.g. financial statements for a separate legal entity and consolidated financial statements). Especially, it should be clarified if the exception for an intra-group monetary item applies to exposures to hedges

[1] A foreign operation is defined as an entity that is a subsidiary, associate, joint venture or a branch of a reporting entity (IAS 21.8). To include also other operating units including the parent company we use the term “operating unit”.

between entities with different functional currencies that are within the same legal entity. The same issue arises for exposures between segments in segment reporting according to IAS 14.

We ask that the board addresses issues related to group firm commitments containing embedded derivatives that are not closely related (above the issue of intra-group firm commitments was briefly mentioned). That may be the case if intra-group firm commitment is denominated in a currency other than any of the functional currencies of the operating units involved. Embedded derivatives that have been separated from firm commitments may not always be eliminated on consolidation. According to IAS 39, embedded currency derivatives are identified vis-à-vis the entity's functional currency. For example, consider a firm commitment denominated in pounds between an operating unit with dollar as its functional currency and an operating unit with euro as its functional currency. The operating unit with a dollar as functional currency has a dollar/pound derivative, and the operating unit with euro as a functional currency has euro/pound derivative. Consequently, full elimination of the identified embedded derivates may be precluded.

Yours sincerely

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