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ΣΥΝΔΕΣΜΟΣ ΕΙΣΗΓΜΕΝΩΝ ΕΤΑΙΡΕΙΩΝ Χ.Α.
ATHEX LISTED COMPANIES ASSOCIATION

Sir David Tweedie
Chairman of the Board
International Accounting Standard Board
30, Cannon Street
London, EC4M 6XH,
United Kingdom

Paris, October 6th, 2004

Dear Sir,

We appreciate the opportunity to offer its views on the Exposure Draft of proposed amendments to "IAS 39 Financial Instruments: Recognition and Measurement – Cash Flow Hedge Accounting of Forecast Intragroup Transactions".

The Exposure Draft proposes to clarify that an entity could designate a highly probable forecast *external* transaction denominated in a currency other than the group's presentation currency as the hedged item.

With regard to the hedge of forecast intragroup transactions, an entity would be permitted to "use *the* forecast intragroup transaction as part of the *tracking mechanism* for associating *the* hedging instrument with *an* external transaction", if (and only if) this transaction is designated as the hedged item.

The IASB proposals generally do not reflect the economy of operations

Although the proposals may be useful in specific and limited circumstances, they are not sufficient to reflect more effectively the economy of forecast transactions, the hedge of their exposure to foreign currency risk, which is explicitly recognised by IAS 39 for external transactions and by SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* for both external and intragroup transactions.
Also, they fundamentally challenge the currency risk management and hedging policy for groups, and the ensuing organisation, without a genuine advantage.

In particular, the system proposed - use of a forecast intragroup transaction in the tracking mechanism for associating the hedging instrument with an external transaction - would not be suited to the numerous cases where there is no direct, individual and / or immediate relationship between the external and intragroup transactions, such as the following:

- The external transactions and the hedging instruments are entered into by separate group entities;
- There is a period of time between the internal transactions and the external transactions;
- Internal purchases by a group entity are used in that entity's production process before external sale;
- The foreign currency risk is managed on a portfolio basis, rather than on an item by item basis.

Also the rationale for the proposed amendments of IAS 39 neither shows consistency nor a genuine conceptual advantage. Unlike external forecast transactions, it does not take into account the economic fact that, even if highly probable forecast intragroup transactions are not recognised in the financial statements, their hedged portion result in the recognition of monetary items, for which foreign exchange gains or losses are not fully eliminated on consolidation and hedge accounting is permitted under IAS 39. It is hard to understand why IAS 39 permits hedge accounting for forecast external transactions and intragroup monetary items and would prohibit hedge accounting for forecast intragroup transactions.

Other major concerns and consequences are still to be addressed

The application of the IASB proposals relating to the hedge of forecast intragroup transactions continue to result in major difficulties, both in terms of volatility and difference with US GAAP:

- In the many cases where it would not be allowed to designate highly probable forecast intragroup transactions as hedged items, volatility would artificially increase, as the gains and losses on the hedging instruments would generally have to be recognised in profit or loss ahead of the associated gains or losses on the hedged forecast transactions;
- The proposals do not eliminate the differences from US GAAP created by the revised IAS 39 and the deletion of IGC 137-14. It is worth noting that, unlike the IASB, SFAS 133 permits hedge accounting for foreign currency risk on a forecast intragroup transaction or a group of forecasted foreign-currency-denominated transactions.

An alternative approach is necessary and justified by the economic background and the way companies manage their foreign currency risk

In the current economic environment, intragroup transactions are more and more frequent and equivalent to transactions concluded with third parties. Forecast intragroup foreign-currency-denominated transactions generally are highly probable. Forecast monitoring permits to demonstrate the realisation of the hedged portion of the forecast intragroup transactions.

Forecast intragroup transactions denominated in a currency other than the group's presentation currency result in a foreign currency risk when initiated, rather than when internal or external transactions are realised. This currency risk is confirmed upon recognition of the intragroup monetary items (receivable, payable, cash) resulting from the goods delivered or services rendered.

The currency risk monitoring and management are essential elements of an international group's management. In this respect a company, as part of its currency risk hedging policy, may wish to hedge all or part of forecast or realized transactions, be they intragroup or external.

The number of currency-denominated transactions, their increasing frequency and the distribution of activities within a group imply that the foreign currency risk often is, or can only be, managed on a portfolio basis, rather than on an item by item basis.

In this context, our proposals are the following:

a) Similarly as for forecast external transactions, recognise the designation as hedged items of highly probable *forecast intragroup transactions* and, like US GAAP, do not require to establish a relationship with forecast external transactions;

b) Permit hedge accounting for a *group* of forecast intragroup transactions (like US GAAP);

c) Recognise the principle of macro-hedging of foreign currency risk: As permitted for a portfolio hedge of interest rate risk, *the hedged item should be capable of being designated in terms of an amount in a maturity time period, rather than as individual transactions or a group of individual transactions.* Hedging conditions for forecast transactions should be assessed globally;

d) Recognise explicitly the practice of hedging the foreign currency risk relating to a portion of the amount of forecast transactions, such as a percentage of forecasted sales during a time period.

We would be pleased to discuss these proposals further and thank you for your consideration of our views.

Yours sincerely,

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DETAILED RESPONSE TO THE IASB EXPOSURE DRAFT "CASH FLOW HEDGE ACCOUNTING OF FORECAST INTRAGROUP TRANSACTIONS

In view of the questions asked under question 2 ("How would you address the concerns?") and under question 1 ("What changes do you propose?"), we have chosen to start analysing and assessing the IASB proposals in our response to question 2 and to set out our proposals in our response to question 1.

QUESTION 2 – ASSESSMENT OF THE IASB PROPOSALS

IASB questions

Do the proposals contained in this 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 those concerns?

Concerns

According to paragraph 3 of the Background, constituents raised the following concerns:

a) it is common *practice* for entities to designate a forecast intragroup transaction as the hedged item. Also previously, IGC 137-14 (now deleted) permitted the designation of the forecast intragroup transaction as the hedged item in a foreign currency cash flow hedge, provided the conditions prescribed in the IGC were met, i.e. the transaction:
   - is highly probable;
   - meets all other hedge accounting criteria; and
   - will result in the recognition of an intra-group monetary item for which exchange differences cannot be eliminated in consolidated net profit or loss.

b) some entities using IFRSs and entities that are planning to adopt IFRSs in 2005 have established a *practice* of designating forecast intragroup transactions as hedged items and have entered into derivative instruments to hedge the resulting exposures;

c) the revised IAS 39 creates a difference from US GAAP because SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* permits hedge accounting for foreign currency risk on forecast intragroup transactions.

However, more fundamentally, beyond the practical aspects set forth in paragraph 3 and the difference created from US GAAP, we also mentioned that the deletion of IGC 137-14 does not make it possible to reflect the economy of operations - the hedge of an exposure to foreign *currency risk - and artificially increases volatility; as the gains and losses on the hedging instruments generally would have to be recognised in profit or loss ahead of the associated gains or losses on the hedged forecast transactions.*

Criteria for assessing the proposals

In summary, to appropriately address all concerns raised, the proposals should meet different criteria and should:

a) Reflect the economy of operations and not challenge the management and currency risk hedging policy for groups, and the ensuing organisation, without a genuine benefit;
b) Not create an unjustified volatility;
c) Be conceptually valid;
d) Not create differences from US GAAP, unless it is relevant and justified.

Responding to the question whether the proposals appropriately address the concerns raised implies to consider the current provisions and IASB proposals, the rationale for the proposals and to assess the proposals against the above mentioned criteria.

Current provisions and IASB proposals

IAS 39 allows designation as the hedged item of a monetary item transacted between two group entities that have different functional currencies.
Paragraph 80 indicates that the foreign currency risk of an intragroup *monetary item* (eg a payable/receivable between two subsidiaries) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to *foreign exchange* rate *gains or losses* that are *not fully eliminated on consolidation* under IAS 21 *The Effects of Changes in Foreign Exchange Rates.* Under IAS 21, foreign exchange gains or losses are not fully eliminated on consolidation when the intragroup monetary item is *transacted between two group entities that have different functional currencies.*

The proposed Application Guidance would clarify that a group can designate as the hedged item a highly probable forecast external transaction denominated in the functional currency of a group entity (eg subsidiary) other than the group's presentation currency ("provided the transaction gives rise to an exposure that will have an effect on consolidated profit or loss (ie denominated in a currency *other than the group's presentation currency*)"). Such transaction would ultimately have effects on consolidation.

With regard to the hedge of forecast intragroup transactions, the Board notes (Background § 4) that the revised IAS 39 permits entities that had designated a forecast intragroup transaction as the hedged item to obtain hedge accounting by designating a highly probable forecast external transaction ***as*** *the hedged item. The Board further notes that if the hedge is designated in this way, entities can use the forecast intragroup transaction as part of the tracking mechanism (or 'audit trail') for associating the hedging instrument with an external transaction.* Also if, as is often the case, the external transaction is for a higher amount than the intragroup transaction, the entity could designate a part of the highly probable forecast external transaction as the hedged item.

A contrario, if the hedge is not designated in the way mentioned, it would not be allowed to designate a highly probable forecast intragroup transaction as the hedged item in consolidated financial statements, as was the case under former IGC 137-14 (Exposure Draft BC 7).

The IASB rationale for not permitting a forecast intragroup transaction to be designated as the hedged item

The rationale for the Board decision not to allow the designation of a highly probable forecast intragroup transaction as the hedged item is that such a transaction *does not result in amounts that are not fully eliminated on consolidation under IAS 21* (condition laid down under IAS 39.80; see above), *as it is not recognised in the financial statements.*

In addition, the Board cannot see another valid conceptual rationale (Exposure Draft BC 7).

Assessment of the IASB proposals and rationale

Based on the criteria mentioned above, our assessment is as follows:

a) Economy of operations

The proposal *recognises the possibility to use a forecast intragroup transaction as part of **a** tracking mechanism* (or 'audit trail') for associating ***a*** hedging instrument with ***an*** external transaction.

However there is not necessarily a direct and/or immediate relationship between a forecast intragroup transaction in a foreign currency and a forecast external transaction in the same currency, in terms of realisation dates and/or amounts.
Therefore a tracking condition would often be difficult to fulfil, in particular in the following cases:

- *The external transactions and the hedging instruments are entered into by separate group entities;*
- *There is a period of time between the external transactions and the internal transactions;*
- *Internal purchases by a group entity are used in that entity's production process before external sale;*
- *The foreign currency risk is managed on a portfolio basis, rather than on an item by item basis.*

Due to these difficulties, it is *useful*, as stipulated in IAS 39.80 *to be able to designate a portion of* ***an*** *external transaction as the hedged item and*, as set out in BC 10 (continuing the example in paragraph BC 2 and 3), *to "designate the first $ 100 of the $ 120 sale proceeds"*.

However, we note that *the proposed application guidance does not state explicitly that the hedged item may be designated in terms of an amount in a maturity time period, rather than as individual transactions*, as permitted for a portfolio hedge of interest rate risk.

b) *Volatility*

In the many cases where it would not be allowed to designate highly probable forecast intragroup transactions as hedged items, volatility would artificially increase, as the gains and losses on the hedging instruments would generally have to be recognised in profit or loss ahead of the associated gains or losses on the hedged forecast transactions.

c) *Conceptual rationale*

As mentioned, the rationale for the Board decision is that a highly probable forecast intragroup transaction does not result in amounts that are not fully eliminated on consolidation under IAS 21, "as it is not recognised in the financial statements"

This rationale is based on IAS 39.80 alone, and more on its form than on its substance.
It does not take into account the economic fact that, even if such a transaction is not recognised in the financial statements, it will generally result in the recognition of an intragroup monetary item for which foreign exchange gains or losses are not fully eliminated on consolidation (under IAS 21).

Moreover the existence of a foreign currency risk on forecast transactions is explicitly recognised by IAS 39.80 for external forecast transactions.

Neither IAS 39 nor the Exposure Draft clarify why this conceptual rationale is regarded as valid for external forecast transactions and not for highly probable intragroup forecast transactions, the result of this being that a same intragroup transaction could be eligible for hedge accounting in the individual financial statements and not in the consolidated financial statements.

d) *Comparison with US GAAP*

Unlike the IASB, SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* permits hedge accounting for foreign currency risk on a forecast intragroup transaction ("forecasted intercompany transaction") or a group of forecasted foreign-currency-denominated transactions.

The IASB proposal does not eliminate the difference from US GAAP created by the revised IAS 39 and the deletion of IGC 137-14.

<u>Conclusions of the response to question 2 - Why the concerns raised by companies are not appropriately addressed</u>

(Conclusions based on the paragraphs "concerns" and "assessment" above)

The proposals do not address all the concerns raised by companies, in particular in terms of the economy of operations or volatility (see § "concerns").

For the concerns addressed, the proposals do not address them appropriately in all respects:

Although the proposals may be useful in certain circumstances and on certain conditions (possibility to use a forecast intragroup transaction as part of a tracking mechanism for associating a hedging instrument with an external transaction; or to designate a portion of an external transaction), they are not sufficient to reflect more effectively the economy of operations - the hedge of an exposure to foreign currency risk, which is explicitly recognised by IAS 39 for external forecast transactions - .
Also, they fundamentally challenge the currency risk management and hedging policy for groups, and the ensuing organisation, without a genuine advantage.

In particular, the system proposed – use of a forecast intragroup transaction in the tracking mechanism for associating the hedging instrument with an external transaction – should be optional or applied only in specific circumstances, as it would not be suited to many cases, such as the following situations:

- *The external transactions and the hedging instruments are entered into by separate group entities;*
- *There is a period of time between the internal transactions and the external transactions;*
- *Internal purchases by a group entity are used in that entity's production process before external sale;*
- *The foreign currency risk is managed on a portfolio basis, rather than on an item by item basis.*

In this respect, unlike SFAS 133, the Exposure Draft does not mention the possibility to hedge a group of forecast intragroup transactions.

Also, regarding the designation of a portion of an external transaction, it is not sufficiently clear in the proposal that the hedged item may be designated in terms of an amount in a maturity time period, rather than as individual transactions, as permitted for a portfolio hedge of interest rate risk.

While the proposals generally do not reflect the economy of operations and are not consistent with currency risk management practices, the rationale for the proposed amendments of IAS 39 neither shows consistency nor a genuine conceptual advantage.
Unlike external forecast transactions, it does not take into account the economic fact that, even if a highly probable forecast intragroup transaction is not recognised in the financial statements, it will generally result in the recognition of a monetary item for which foreign exchange gains or losses are not fully eliminated on consolidation.

Finally, the proposals do not show great improvement on the current situation, both in terms of volatility and difference with US GAAP:
- *In the many cases where it would not be allowed to designate highly probable forecast intragroup transactions as hedged items, volatility would artificially increase, as the gains and losses on the hedging instruments would generally have to be recognised in profit or loss ahead of the associated gains or losses on the hedged forecast transactions.*
- *The proposals do not eliminate the difference from US GAAP created by the revised IAS 39 and the deletion of IGC 137-14.*

Our response to the question regarding how to address the concerns is combined with our response to the question "what changes do you propose?" (under question 1 below)

QUESTION 1 – ECONOMIC BACKGROUND AND PROPOSALS

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

For the reasons detailed in our response to question 2 (see "conclusions" above), we believe that the proposals in the Exposure Draft correspond to a limited number of cases and are not sufficient to appropriately address the foreign currency hedge of forecast intragroup transactions.

In order to address the concerns and meet the assessment criteria specified above, we have developed alternative proposals regarding the foreign currency hedge of such transactions. We have found it useful to first highlight the economic background of those transactions.

Economic background of the forecast intragroup transactions

Forecast intragroup foreign-currency-denominated transactions generally are highly probable. Forecast monitoring permits to demonstrate the realisation of the hedged portion of the forecast intragroup transactions.

In the current economic environment, intragroup transactions are more and more frequent and equivalent to transactions concluded with third parties.

Forecast intragroup transactions denominated in a currency other than the group's presentation currency result in a foreign currency risk when initiated, rather than when internal or external transactions are realised. This currency risk is confirmed upon recognition of the intragroup monetary items (receivable, payable, cash) resulting from the goods delivered or services rendered.

The currency risk monitoring and management are essential elements of an international group's management. In this respect a company may wish to hedge all or part of forecast or realized transactions, be they intragroup or external, as part of its currency risk hedging policy.

The number of currency-denominated transactions, their increasing frequency and the distribution of activities within a group imply that the foreign currency risk often is, or can only be, managed on a portfolio basis, rather than on an item by item basis.

<u>Our proposals</u>

In this context, our proposals are as follows:

a) <u>Do not require to establish a relationship with forecast external transactions</u>

Similarly as for forecast external transactions, IAS 39 should explicitly recognise the designation as hedged items of highly probable forecast intragroup transactions and, like US GAAP, should not require to associate a forecast intragroup transaction (or forecast intragroup transactions) with a forecast external transaction (or forecast external transactions).

b) <u>Permit hedge accounting for a group of forecast intragroup transactions</u>

Like under US GAAP, it should be possible to apply hedge accounting to a forecast intragroup transaction or a group of forecast intragroup transactions.

c) <u>Recognise the principle of macro-hedging of foreign currency risk</u>

As permitted for a portfolio hedge of interest rate risk, the hedged item should be capable of being ***designated in terms of an amount in a maturity time period, rather than as individual transactions or a group of individual transactions****. Hedging conditions for forecast transactions should be assessed globally.*

d) Recognise explicitly the practice of hedging the foreign currency risk relating to a portion of the amount of forecast transactions

For forecast intragroup transactions as well as for forecast external transactions, IAS 39 should explicitly recognise the practice of hedging the foreign currency risk relating to a portion of the amount of forecast transactions, such as a percentage of forecasted sales during a time period.

Where applicable, it should be possible to use hedge accounting until the realisation of the percentage hedged.

The rationale for our proposals

Our proposals address all concerns raised and meet the different criteria set out above:
a) They reflect more effectively the economy of operations, as described in the background paragraph, and do not challenge the management and currency risk hedging policy for groups, and the ensuing organisation;
b) They do not create an unjustified volatility;
c) They are conceptually valid and consistent; allowing the foreign currency hedge of forecast intagroup transactions amounts to applying the IAS 39 hedge accounting of both intragroup monetary items and forecast external transactions.
d) They do not create differences from US GAAP, unless it is relevant and justified.

QUESTION 3

Do you have any other comments on the proposals?

No other comments on the IASB proposals than under question 2.