acteo Association pour la participation des entreprises françaises à l'harmonisation comptable internationale

Mouvement des Entreprises de France
MEDEF

Ms Sandra Thompson
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JK/SJ/10.2004./42
RE : IAS 39 : Cash-flow hedges of future intra-group transactions

Paris, October 8th , 2004

Dear Ms Thompson,

ACTEO & MEDEF welcome the opportunity to comment the IASB exposure draft on IAS 39: Cash-flow hedges of future intra-group transactions.

ACTEO & MEDEF believe that the exception included in the IGC 137-14 should be reinstated into IAS 39 because cash flow hedges of intra-group forecast transactions are designed to hedge an existing currency exposure that could ultimately affect profit and loss.

Furthermore the issue arose at the time the amended IAS 39 was issued and did not follow the adequate due process. The outcome is therefore very similar to a breach of the stable platform.

Our detailed analysis is included in the appendix to this letter.

We remain at your disposal should you need further clarification or background information.

Yours sincerely,

ACTEO	**MEDEF**
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Le Président	
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Le Délégué Permanent	La Directrice des Affaires Economiques, Financières et Fiscales

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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 this Exposure Draft because we believe that the alternative solution, i.e. reinstating IGC 137-14 into an amendment to IAS 39.80, is a preferable solution:

- accounting would remain closely related to the management of the group's exposure to currency risk;
- cash-flow hedge accounting for intra-group future transactions is consistent with the hedge accounting that is permitted under IAS 39, paragraph 80; the hedge of a future intra-group transaction is entered into in order to hedge the very same risk exposure as is recognised once intra-group payable/receivable are accounted for. Re-enlarging the exception of paragraph 80 to encompass intra-group transactions at the stage of forecast transactions is therefore in line with hedging of economic exposures, not only accounting exposures; it is also compliant with 39.88, that requests in c) that "*for cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that would ultimately affect profit or loss*".
- the requirements would remain in convergence with US Gaap;
- the application of the proposed AG 99A would result in the documentation of a virtual set of cash-flow hedges, established at corporate level for the sake of consolidated accounts, without any link with the actual management of currency risk.

Question 2
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 these concerns?

In our response to question 1, we explain why we believe the concerns set out in paragraph 3 of the background on this Exposure Draft are not satisfied:

- forecast intra-group transactions may be no longer designated as the hedged item although, in practice, risk management is built thereon,
- convergence with US Gaap is disrupted by the Board's decision to eliminate IGC 137-14.

In paragraph 3 of the background on the Exposure Draft, the Board mentions that "some" entities do enter into derivative instruments to hedge currency exposures resulting from forecast intra-group transactions.

We would like to stress to the Board that not only "some entities" are concerned, but almost all widely spread international corporations of great economic significance. In order to cut down costs and boost efficiency, manufacturing facilities have been concentrated in some countries and are entrusted with feeding the distribution networks of all other countries in the regional area. The currency used in those exchanges is only by coincidence the presentation currency of the group.

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To ensure the greatest efficiency and sound internal control, currency risk management is ensured at the local level, even if subsidiaries enter into derivative transactions under the tight control of a central treasury department. The currency exposure which is to be hedged therefore exists structurally. It does not arise from the transactions themselves but has been created at the time the organisation was put in place.
Hedging instruments are therefore entered into on the basis of future transactions, including intra-group transactions, as soon as those forecast transactions are highly probable. They are meant to ensure that the level of profitability that has been secured for the operations in the group is not impaired by unmonitored currency exposures in too short a period to let management make adequate decisions in order to counteract adverse evolutions of currency exchange rates.
To exclude those forecast transactions from hedge accounting would therefore undermine the faithful representation of an entity's profitability.

The clarification proposed by the Board would allow entities to document, at the corporate level, most of the derivative transactions they have entered into as hedging relationships that would satisfy IAS 39 criteria. Indeed, the corporations concerned do sell in most currencies that they use for their intra-group transactions. This would however be at the cost of a separate set of hedging documentation, established for accounting purposes only, without any link to the actual group's risk management policies. We believe that this would result in:

- destroying shareholders' value, since supplementary costs would be incurred, without any added value to the entity or its shareholders,
- providing users with irrelevant information in the notes to the financial statements (as required today through IAS 32 or as proposed in ED7), since the hedging relationships that would be described and illustrated would not be the actual hedging relationships that the group has entered into.

Question 3
Do you have other comments on the proposals?

Whichever decision the Board will make ultimately, IFRS applicable in 2005 should include the exception contained in the deleted IGC 137-14. This IGC has been deleted without adequate due process:

- the exposure-draft "Amendments to IAS 39" issued in July 2002 included a table allowing to assess the impact that the amendments were supposed to have on the implementation guidance available to IAS 39; the exposed table shows that IGC 137-14 was supposed neither to be incorporated into the standard, nor to be affected by the standard;
- no public deliberation was held, on the basis of the comments received, on the issue of cash-flow hedges of future intra-group transactions; no decision has been reported in the IASB Update;
- no change is mentioned in the introduction to the amended IAS 39;
- to find out that the IGC has been deleted, it is necessary to refer to the concordance table.

We therefore believe that IGC 137-14 (or its content) has to be applicable in 2005. Consequently, if the Board were to maintain their decision, it would be deleted only as of January 1, 2006.
Entities have indeed planned their conversion process on the basis of the existing literature and of the changes that were expected. The deletion of IGC 137-14 is therefore as damageable as a breach of the stable platform.

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