UNICE

THE VOICE OF BUSINESS IN EUROPE

22.7/8/1 8 October 2004

Mrs Sandra Thompson
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear Mrs Thomson,

RE: CASH-FLOW HEDGES OF CURRENCY RISK IN FUTURE INTRA-GROUP TRANSACTIONS

In response to your consultation on the above-referenced exposure draft, UNICE would like to offer the following remarks.

We believe the IASB did not choose the best answer from among the alternatives that it has considered to solve the issue. Taking all arguments set forth in the Basis for Conclusions into account, we believe that the exception previously contained in IGC 137-14 is the preferable solution. It is indeed the solution that is the most closely linked to the economic currency exposures born by entities, and therefore most closely reflects widespread sound risk management practices. Our detailed analysis is set out in the attached appendix to this letter.

It is also the solution that reinstates the convergence with US Gaap. In our view, IASB should not adopt changes in application guidance that result in additional reconciliation items, when in principle convergence is achieved.

We also include copy of the letter that UNICE sent out in early June this year to Sir David Tweedie, requesting that the exception withdrawn without adequate due process be reinstated to be applicable in 2005. We do not believe that this issue has received adequate attention. The letter is therefore still valid.

We hope you give due consideration to our comments and remain at your disposal should wish to discuss these issues further.

Yours sincerely,

Jérôme P. Chauvin
Director, Company Affairs Department

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Appendix

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 they do not constitute the best answer possible to the concerns summarised in IN3. The proposal put forward to the Board would:

- impair the transparency and reliability of financial reporting: entities would be required to identify and document, at the corporate level, future external cash-in- or outflows to match in amount and timing the cash-flows generated by the hedging instruments entered into, although these hedging relationships would not be the actual hedging relationships set up by the entity as a result of its risk management policy;
- increase administrative costs without any corresponding benefit for the shareholder: the hedging relationships documented at the corporate level would be virtual. The burden of documentation is therefore an undue cost. It is also a supplementary cost, since entities can not abandon the normal, sound identification and documentation process of the actual hedging relationships set up within the group;
- create supplementary and unwelcome divergences with US GAAPs have acknowledged the economic underlying reality of hedging intra-group future transactions. Such divergences constitute a severe distortion of the transatlantic level playing field, not only because of the lack of understandability of the earnings reported under IFRS, but also because the accounting procedures would be more costly.

Furthermore, to disqualify intra-group future intra-group transactions as hedged items is inconsistent with the exception included in IAS 39, paragraph 80. The currency risk exposure is created structurally by the internal organisation of any group with international operations. In order to optimise the return on capital, manufacturing facilities are operated in only a few countries in the world. These facilities serve numerous distribution facilities, all spread out in various countries within their geographical areas. Intra-group exchanges occur in the functional currency of either the selling or the purchasing entity, which is only coincidentally the same as the group's presentation currency. When future transactions become highly probable, hedging derivatives are entered into, generally to cover the next budgetary cycle, which represents the shortest span of time possible to react to a change in economic conditions. The currency exposure which is eligible for hedges according to IAS 39, paragraph 80, is indeed generated earlier, at the time when intra-group transactions become highly probable. It seems inconsistent to authorise hedge accounting of the currency exposure associated with intra-group payables and receivables, and to prohibit it at the time the same exposure is generated and the hedging relationship is entered into.

Typically, currency risk management is carried out locally, even if entering into external hedging instruments remains under the control of a central Treasury Department. All entities in the group have to comply with the same policy that prohibits any currency exposure remaining unhedged.

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?

For the reasons explained in our answer to question 1, we do not believe that the proposals made in the Exposure Draft appropriately address the concerns set out in paragraph 3 of the background on this Exposure Draft.

We believe that the exception previously contained in the deleted IGC 137-14 should be reinstated, in an extension to paragraph 80 of IAS 39.

However, the worst possible solution in our view would be to drop the Exposure Draft and do nothing.

Should the Board decide not to reinstate the former exception, we offer our help in drafting an improved version of the proposed application guidance.

Question 3
Do you have other comments on the proposals?

We refer to our previous letter dated early June this year when we stressed that the deletion of IGC 137-14 did not result from an adequate due process.

We therefore reiterate that IAS 39 requirements applicable in 2005 should be the requirements that entities rigorously planning their conversion process were bound to expect, taking into account the proposed amendments and the decisions made and announced following deliberations of comments received.

The deletion of IGC 137-14 was not considered at the time of the exposure draft. It was not discussed publicly thereafter. It was not announced as part of the changes in the introduction to the amended IAS 39.