ACCA

FRED51 Amendments to FRS102 – hedge accounting

Exposure draft issued for comment by the Financial Reporting Council

Comments from ACCA

14 February 2014

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Further information about ACCA's comments on the matters discussed here may be obtained from the following:

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ACCA welcomes the opportunity to respond to the above exposure draft. Our Corporate Reporting Global Forum of members has considered the proposals, and its views are reflected in the following general and specific comments.

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GENERAL COMMENTS

ACCA supports the amendment because we see the advantages of this amendment including

- Alignment with the new IFRS9 and so with the future accounting by listed companies (use of IFRS9 is not allowed in UK at present)
- accounting more aligned with risk management and a (little) less rule-based than the IAS39 model

However we note that it would represent

- Further departure of FRS102 from IFRS for SMEs, with no guarantee that IFRS for SMEs will go this way when amended in future
- Change in a critical area for UK companies with less than a year before implementation
- Perception of a regime of change and tinkering with FRS102

Hedge accounting has been identified as one of the key areas of change for UK companies as they switch to FRS102. Hopefully not too many companies have invested much time and effort into considering and implementing the hedge accounting in current FRS102, given these proposed amendments. It is not ideal that the new accounting in this amendment is only here in draft form when for many the date of transition to FRS102 has passed already. It is important that this amendment is finalised as soon as possible. Further amendments

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should be avoided if at all possible for a period while FRS102 is implemented.

The implementation of the new hedge accounting model may proceed rather quicker in the UK via FRS102 (i.e. during 2014 and 2015) than is the case with IFRS9 where the earliest mandatory date appears to be 2017. In some areas FRS102 implementation might be easier with experience from IFRS9, but it looks now that will not be the case.

SPECIFIC COMMENTS

We now comment on the specific questions raised as follows:

Q1. Do you support the adoption of the 3 hedge accounting models as set out in this FRED? If not, why not?

We support the hedge accounting model being proposed particularly as this will align the language of FRS102 with both IAS39 and IFRS9. We have noted some of the reasons for that and some of the issues it raises in our general comments above.

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Q2. Do you agree with the overarching approach of setting the requirements for hedge accounting in a way that can be straightforwardly applied by entities undertaking relatively simple economic steps to manage risk? If not, why not?

Yes. We welcome the greater flexibility given by these changes to

- use instruments other than derivatives for designated hedges
- allow for portions of hedged items and hedging instruments to be used

Q3. The draft amendments require an economic relationship between the hedging instruments and the hedged item. Do you agree with this approach to establishing whether a hedging relationship exists? If not, why not?

Yes, we agree with the general approach. However we note that a debate over what will constitute "an economic relationship" will inevitably arise. The term is being used in IFRS and so there will no doubt in due course be more guidance on this aspect as IFRS9 comes to be implemented. However as noted above UK application of the concept via this amendment to FRS102 may well come first.

Q4. The draft amendments have the effect of removing the requirement to make binary assessment at the beginning of a hedging relationship that defines that hedge as effective or ineffective. The effect of this would be to allow hedge accounting

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to be used for the effective portion of any relationship meeting the qualifying conditions. Do you agree with this approach?

Yes. However, as noted above in answer to Q3, the burden of the effectiveness test will be replaced by a consideration of whether there is an economic relationship or not. That is a better more principles-based consideration and moves away from the current bright line test.

For the most common hedging arrangements either assessment would probably be fairly straightforward. However removing the requirement is arguably an easy way of allowing portions of hedging instruments to be used. Hedge ineffectiveness will emerge and be charged to P&L in any case.

Q5. The draft requirements for net investment hedges state that when a hedging relationship is discontinued, amounts deferred in equity may not be reclassified to profit or loss. Do you agree with this proposal, or should recycling of gains or losses on hedging instruments be permitted regardless of the mismatch with the foreign currency movements?

We note that there will be an inconsistency here. When a net investment hedging relationship is discontinued the amounts which have gone through OCI to equity will not be recycled to P&L (on disposal of the foreign operation for example) even though there will be a profit or loss on disposal recognised. No recycling of the exchange gains or losses is inconsistent with IFRS9. However it would

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be consistent with the current FRS102 (e.g. paragraph 30.13) which is the more important issue.

Q6. The draft amendments proposes an alteration to Section 11 of FRS102 to broaden the range of instruments that may be designated at fair value through profit or loss, with the effect of allowing in some cases economic hedging. Do you agree with these changes?

We agree. However we would note that economic hedges include all the risks including the credit risk and so may not give rise to equivalent recognition as other forms of hedge accounting.

Q7. Included as non-mandatory guidance are the examples of the three proposed hedge accounting models (appendix to section 12). In your view are these helpful application guidance of the requirements of paragraphs 12.15 to 12.25?

Yes. Hedge accounting is a new aspect of standards for most UK companies and so the examples are helpful in illustrating the different models.

Example 1 cash flow hedge might indicate that the change in fair value at 31 December 20X5 that is recognised in OCI does go to a cash flow hedge reserve on the balance sheet (from where it appears in 20X6 to reduce the cost of PPE).

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Q8. The draft amendments propose a transitional exemption which will allow certain one-off re-measurements of hedging instruments and hedged items at the transition date. Do you believe that these exemptions facilitate application of hedge accounting to arrangements in place at transition?

Yes we agree with these.

Other comments:

Two of the main differences with IFRS9 are covered by Q4 and Q5 above. The other main difference is that hedge accounting can be voluntarily disapplied at any point under these proposals, in common with IAS39 and the current requirements in FRS102. We support that proposal.

We note that there is material guidance in IFRS9 on

- The time value of options
- The forward element of forward currency contracts
- Credit exposure at fair value through P&L
- Hedging groups of items

These have been deemed complexities in IFRS9 that should not be needed in FRS102. While we agree these should not be included in FRS102 the first three of these are significant improvements in IFRS9 and so should not be seen as prohibited and should be available for UK companies via paragraph 10.6 of FRS102.

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