Rechnungslegungs Interpretations
Accounting Interpretations Committee

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Mr Robert Garnett
Chair of the
International Financial Reporting Interpretations Committee
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Dear Bob

Comment Letter on IFRIC Interpretation D22 *Hedges of a Net Investment in a Foreign Operation*

We appreciate the opportunity to comment on the draft Interpretation IFRIC D22. We fully endorse the IFRIC's aim to support the IASB in establishing and improving International Financial Reporting Standards.

In our view, IAS 39 *Financial Instruments: Recognition and Measurement currently* provides only very limited guidance on hedges of net investments in a foreign operation. In addition, we feel that clarifying the interaction between IAS 39 and IAS 21 *The Effects of Changes in Foreign Exchange Rates* would improve International Financial Reporting Standards and avoid divergence in practice.

We agree with the consensus reached in IFRIC D22. In particular,

- we think that only the differences between the different functional currencies should be eligible for hedge accounting. In our view, hedge accounting should not be applicable to the foreign exchange differences arising between the functional currency of the foreign operation and the presentation currency of the parent entity.
- we concur with the IFRIC's view that hedge accounting may be applied by any parent entity (be it the immediate, an intermediate or the ultimate parent entity) of the foreign operation. This view takes into account that within a group, there are different possibilities, in accordance with the entities' risk management strategies, to hedge of the exposure(s).
- we therefore also agree with the consensus in that the hedging instruments can be held by any entity within the group.

Although we support the consensus contained in IFRIC D 22, we think that some parts of the Interpretation could be improved. Please find our detailed suggestions in the appendix to this letter.

If you would like further clarification of the issues set out in this comment letter, please do not hesitate to contact me.

With best regards

Manfred Bolin
AIC, Chairman

Appendix

Par. 11 of IFRIC D22 states that “the requirements of IAS 39 paragraph 88 apply to the hedge of a net investment in a foreign operation in a manner similar to that in which they apply to fair value or cash flow hedges.” However, our understanding of IAS 39.88 is that its requirements have to be met for any kind of hedging relationship, be it fair value hedge, cash flow hedge or hedge of a net investment in a foreign operation. Some sub-paragraphs of IAS 39.88 contain additional requirements for a specific kind of hedge (e.g. (c) is applicable only to cash flow hedges). This evidences that IAS 39.88 is *directly* applicable to all kinds of hedges. The wording in par. 11 is therefore confusing, as it seems to be imply that the IAS 39.88 is applicable to net investment hedges only by analogy and not directly.

Par. 12 of IFRIC D 22 acknowledges that there might be more than one hedging instruments. Those hedging instruments may be held “by any entity within the group”. This could be interpreted as, although more than one single hedging instrument is acceptable (as long as the requirements in IAS 39.88 are met), those instruments must be held by *one* entity within the group. We think that those hedging instruments may not only be held by *any* entity within the group, but also by *different* entities within the group, provided the requirements in IAS 39.88 are met. Therefore, we suggest that par. 12 be changed to “the hedging instrument(s) may be held by any entity **<u>or entities</u>** within the group”.

Par. 14 of IFRIC D 22 states that “an exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once”. We think that this is intended to clarify that, although more than one entity within the group may hedge the same exposure, only one of those hedges is eligible for applying hedge accounting. We agree with this conclusion. However, the wording might be misinterpreted in that, after a hedge accounting relationship has ended, the entity is prohibited from making a new designation for a hedging relationship with regard to the same exposure at a later point in time.

Paragraph IE4 states that a “hedge would continue to qualify for hedge accounting in Entity B’s consolidated financial statements only if Entity B had not also hedged its €/NZ$ foreign currency exposure.“ We think that IFRIC D 22 should differentiate between (economic) *hedging* and *applying hedge accounting* to those hedges. In the example, entity B might have hedged its €/NZ$ foreign currency exposure, but refrained from applying hedge accounting to this hedge. Par BC18 contains a similar – potentially confusing - wording.

In IE 14, the journal entries twice refer to „Entity A“ instead of Entity “C”. This seems to be a drafting error, as the forward contract is held by Entity C and the example intends to demonstrate the hedge accounting by entity C.

We do not agree with the statement in BC 7, which refers to par. 18 of the Basis for Conclusions of IAS 21 and states that “the method of translating financial statements will result in the same amounts in the presentation currency regardless of whether the direct method or the step-by-step method is used." On the contrary, we have the impression that, considering how IAS 21 is applied in practice, the method of consolidation (direct or step-by-step) might lead to different results. However, this seems to be a question of divergence in practice when applying IAS 21 and not one of the issues that IFRIC D22 seeks to address. We would encourage the IFRIC to provide guidance on this issue.

BC.12 seems to contain another drafting error. We think that, in line 3, the sentence should refer to *currencies* (rather than *currency*): „The IFRIC noted the following arguments for allowing an entity to designate hedging relationships solely on the basis of differences between functional currenc**ies**."