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Accounting & Tax Committee  
Japan Foreign Trade Council, Inc.  

To the Financial Accounting Standards Board  

Comments on Discussion Paper  
"Selected Issues about Hedge Accounting"  

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) made in response to the solicitation of comments regarding the Financial Accounting Standards Board Discussion Paper “Selected Issues about Hedge Accounting” (hereinafter DP). JFTC is a trade-industry association with trading companies and trading organizations as its core members, while the principal function of its Accounting & Tax Committee is to respond to developments in domestic and international accounting standards. (Member companies of the Accounting & Tax Committee of JFTC are listed at the end of this document.)  

I. General Comments  

The IASB Exposure Draft expands the scope of hedge accounting and eliminates the 80–125 percent numerical criterion, thus enabling accounting practices that are closer to reality. For this reason, we are not opposed to going forward with discussions based on the IASB ED.  

Numerous differences remain between the hedge accounting practices proposed by the IASB and the FASB. From the perspective of ensuring comparability of financial statements, these differences should be further reduced and convergence should be achieved at an early date. We suggest that the IASB and the FASB form a joint expert committee on hedge accounting, issue a joint ED, and publish unified hedge accounting standards. In addition, Hedge accounting stands as an exception to the normal recognition and measurement requirements for financial instruments accounting. Therefore, we request that continued efforts be made to narrow the gap between IFRS and U.S. GAAP in overall standards on financial instruments accounting.
II. Specific Issues (Comments on Questions)

Question 1

We believe the IASB ED proposal would provide useful information on the effects of an entity’s risk management objectives.

Question 2

The IASB ED proposal is unclear on the treatment of certain aspects of the preparation of financial statements. Therefore, we believe it is necessary to provide additional illustrative examples to serve as reference for management in making related decisions. Moreover, we believe that revisions should be made to improve the understandability and usability of the accounting standard for users. The difference with documentation required under the current U.S. GAAP is also unclear and requires further guidance.

Question 3

If the IASB ED proposal for documentation differs from the current U.S. GAAP, we think that the new standard would require changes to be made in documentation. In any case, the difference with documentation required under the current U.S. GAAP is unclear and requires further guidance.

We believe that the IASB ED is designed to more faithfully reflect the risk management objectives of entities in their financial statements, and that the ED proposal will not cause changes in corporate risk management.

Question 5

Entities should be allowed to designate nonderivative financial assets and liabilities as hedged instruments for the following reason.

If there is a relationship in which fluctuations in the fair value or cash flow of hedged items can be offset by using nonderivative financial assets and liabilities, the economic reality of the relationship should be reflected in financial statements. We believe there is no reason to restrict hedging instruments to derivatives.
Question 6

We find portions of the guidance concerning hedged items contained in the IASB ED to be insufficient.

➢ "Highly probable forecast transaction" is given as an eligible hedged item in a cash flow hedge. Guidance should be provided on the timing of the forecast transaction. The only available guidance in IAS39 is found under paragraph F3.11, which we believe to be insufficient.

➢ We do not agree with disallowing the application of hedge accounting to equity instruments designated as at fair value through other comprehensive income. By affecting other comprehensive income (OCI), such equity instruments can generate changes in the statement of financial position and the statement of comprehensive income, which in turn can have an effect on corporate value. For this reason, it can be assumed that entities will hedge against fluctuations in the value of such equity instruments. Disallowing hedge accounting in such cases would generate an asymmetry in accounting and would fail to represent the economic reality of entities.

Question 7

We believe the IASB proposal on risk components is appropriate, as it provides entities with a wide range of choices in hedging strategies.

The IASB guidance on “separately identifiable” and “reliably measurable” is insufficient. The guidance should be expanded to include various illustrative examples.

➢ Regarding investment in affiliates, we request that consideration be given to designating the following risk components as hedged items:

In certain cases, an entity will undertake hedge operations to cover the anticipated cash flow from the forecast transactions of an affiliated company engaged in selling minerals. As the investing company, suppose this entity enters into forward selling contracts to protect itself from future fluctuations in the price of minerals by hedging its share of revenue from future sales of minerals by an equity-method affiliate engaged in mineral extractive activities. From an economic perspective, the investing company has hedged its cash flow from the affiliate's scheduled sales of minerals and has thereby acted to control the fluctuations in its equity-method profit or loss that would be recognized at some point in the future.

However, under both the current and proposed accounting treatments, hedge accounting cannot be applied to such transactions for the
following reasons, and it is normally interpreted that market-price fluctuations pertaining to the forward contract must be recognized in profit or loss.

- Because the cash flow from forecast transactions pertains to the affiliate and does not accrue to the consolidated financial statements of the investing company (other than in exceptional cases where, for example, the affiliate’s cash flow is fully and immediately distributed as dividend), cash flow hedge cannot be applied.

- Because equity-method profit or loss is recognized in profit or loss, fair value hedge also cannot be applied (IASB ED paragraph B8).

Basically, hedging is an action undertaken by management to intentionally control the impact of market fluctuations on the entity’s financial statements. In this context, we believe that hedge accounting is aimed at reflecting such actions in accounting. Paragraph 18 of the ED states that a risk component may be designated as a hedged item when it is separately identifiable and reliably measureable. In the example presented above, the hedging instrument (forward contract) is clearly tied to the affiliate’s hedged item (forecast transactions), and if we adopt the assumption that the hedged item is a transaction undertaken by the investing company, this becomes a transaction to which hedge accounting can be applied. Therefore, hedge accounting should be applicable to an equivalent transaction by the affiliate.

**Question 8**

We do not believe that “separately identifiable” should be limited to risk components that are contractually specified.

Our reasoning is that, as with the example provided in paragraph B15(b) of the IASB ED, there are cases in which risk components are separately identifiable even though they are not contractually specified.

**Question 10**

We find the guidance contained in the IASB ED concerning layer components to be insufficient. The guidance should be expanded to include various illustrative examples.
Question 11

We do not have any concerns regarding the application of other IFRS guidance to aggregated exposures being hedged.

Question 12

We believe the ED guidance on aggregated exposure will provide information that is more transparent and consistent with the purpose of use of derivatives by entities.

Our reasoning is as follows. As in the case of paragraph B15(b) of the IASB ED, if entities are hedging aggregated exposures that contain financial instruments with the characteristics of derivatives, designating these as hedged items will provide information that is consistent with the purpose of the entity.

Question 13

We believe that allowing hedge accounting of transactions to which hedge accounting is inapplicable under current standards will contribute to financial statements that better reflect economic realities.

Question 14

Regarding “expected to achieve other-than-accidental offsetting,” which is included in indicators for assessment of hedge effectiveness, we believe judgment will prove difficult in some cases. Therefore, we request the addition of operational guidances and illustrative examples.

Question 15

We welcome the elimination of the 80–125 percent criterion, as this will allow greater flexibility in hedge accounting in line with the hedging strategies of entities. However, regarding “minimise expected hedge ineffectiveness,” which is included in indicators for assessment of hedge effectiveness, we believe judgment will prove difficult in some cases. Therefore, we request the addition of operational guidelines and illustrative examples.

In addition, we request that the following matter be considered.

> Paragraphs B33–B36 of the IASB ED state the following concerning assessment methods for hedge effectiveness. When the critical terms of
the hedging instrument and the hedged item match or are closely aligned, qualitative assessment is by itself sufficient. Otherwise, quantitative assessment may also be necessary in certain cases.

However, the question of whether or not critical terms are "closely aligned" will require a subjective judgment. Given the expected difficulties in making such judgments in operational situations, we request that the following points be examined.

- To ensure smooth operational application of the ED proposal, we request the addition of more detailed illustrative examples and guidance on "closely aligned."

- Alternatively, we request the adoption of flexible approaches that will allow entities to choose between qualitative and quantitative assessment based on the entity’s risk management strategy. In any case, because hedge ineffectiveness is recognized in profit or loss, there is little significance in undertaking quantitative assessment. We believe no serious problems will result from allowing a choice.

**Question 16**

It is difficult to understand what operational treatment is being called for. Therefore, we request further guidance on cases where rebalancing of hedging relationships is necessary.

**Question 17**

We feel that rebalancing of hedging relationships may lead to confusion in operational methods. Therefore, we believe that detailed guidance is also necessary on rebalancing of hedging relationships.

**Question 18**

Regarding the use of an option to hedge cash flow related to the acquisition of assets, the time value of the option could be considered to be a cost incidental to the acquisition of assets. As in the case of other incidental costs, we believe it would be appropriate to treat this as part of the acquisition price. However, in considering the administrative burden, consideration should be given to allowing this to be recognized in profit or loss.
Question 19

Regarding fair value hedges, we do not believe that gains or losses pertaining to hedging instruments and hedged items must necessarily be recognized in OCI.

The IASB ED proposal ultimately results in the same profit or loss as the current IAS39 standard, which stipulates that gains or losses pertaining to hedged items and hedging instruments should be recognized in profit or loss. As such, there is little real significance in revision. The effects of the proposal are said to be the following: (1) the effects of risk management activities for both cash flow and fair value hedges are presented in one place (paragraph BC123(c)); and (2) information on the extent of offsetting achieved for fair value hedges is provided in OCI (paragraph BC123(d)). With regard to (1), the original intent was not to replace the mechanics of fair value hedge accounting with those of cash flow hedge accounting but to take different approaches. Therefore, we find that there is no compelling reason to present cash flow and fair value hedges in one place. With regard to (2), the same effect can be realized through the disclosure requirement of paragraph 51.

Preparers of financial statements are using accounting principles in line with the current IAS39, and it can be assumed that they have developed various computer systems for this purpose. If revisions are made as proposed in the IASB ED, these computer systems will probably have to be modified. As we have stated above, there is very little real significance in the proposed revision. Therefore, from the perspective of cost and benefit, we cannot support the ED proposal.

Question 20

It is unclear what benefit can be derived from presentation in a separate line item in the statement of financial position. We believe that new items should not be added without due reason.

Question 22

We do not foresee any special problems in disclosures related to risk management.

However, regarding the carrying amount of hedged items and hedging instruments, disclosure by type of hedge (fair value hedge, cash flow hedge, and hedge of a net investment in a foreign operation) and by risk category would entail excessive administrative burdens. On the other hand, it is not clear what benefit would be gained. Similarly, disclosure of
quantitative information for different risk categories also would entail excessive administrative burdens with no clear benefit.

**Question 23**

We believe that the FASB should eliminate the overly detailed rules that exist under U.S. GAAP and should aim to establish standards that are based on principles. However, we are concerned that the disclosure requirements proposed in the IASB ED are too complex and would entail excessive administrative burdens. Therefore, we believe that the good elements of IASB ED and U.S. GAAP should be brought together to achieve convergence between the two standards. In the event that the option of convergence is not adopted, the application of U.S. GAAP should be synchronized with the mandatory application of IFRS in the United States in order to avoid operational confusion.

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