



NEED TO KNOW

Hedge Accounting
(IFRS 9 *Financial Instruments*)

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1. INTRODUCTION

In November 2013, the International Accounting Standards Board (IASB) published IFRS 9 *Financial Instruments* (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39). Most changes relate to new hedge accounting requirements, with others deferring the effective date of IFRS 9.

The new hedge accounting requirements have been developed from the proposals in Exposure Draft ED 2010/13 *Hedge Accounting*, which was issued in December 2010 as part of the third phase of the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement*.

The existing 2015 effective date of IFRS 9 has been deleted, and the IASB has left the effective date open until all the other outstanding phases of IFRS 9 have been finalised. However, the new hedging requirements in IFRS 9 are available for early adoption (provided the classification and measurement requirements in IFRS 9 are also adopted at the same time).

The new hedge accounting requirements are more principles based, less complex, and provide better links to entities' risk management activities than the existing hedge accounting model in IAS 39. The new model would allow entities to apply hedge accounting more broadly to manage profit or loss mismatches and improve what might be regarded as being 'artificial' hedge ineffectiveness.

Key changes introduced by the new model include:

- Simplified effectiveness testing, including removal of the 80-125% highly effective threshold
- More items qualify for hedge accounting, e.g. pricing components within a non-financial item, and net foreign exchange cash positions
- Entities can more effectively hedge account exposures that give rise to two risk positions (e.g. interest rate risk and foreign exchange risk, or commodity risk and foreign exchange risk) that are managed by separate derivatives over different periods
- Less profit or loss volatility when using options, forwards and foreign currency swaps
- New alternatives are available for economic hedges of credit risk and 'own use' contracts which has the potential to reduce profit or loss volatility.

Entities engaging in economic hedging activities (regardless of whether they apply hedge accounting under IAS 39) have the potential to benefit most from the changes. Examples include:

- Corporates in the mining and natural resources, airlines, agriculture and other commodities industries
- Entities with significant foreign currency transactions or foreign source funding that use derivatives to manage risk in their business activities.

Entities have often found that the hedge accounting requirements under IAS 39 are restrictive and have led them to either not be able to apply hedge accounting or, in some cases, modifying their risk management approaches to comply with the IAS 39 requirements. The new hedge accounting model will allow entities to better reflect their risk management activities in their financial statements. Management may wish to consider the new requirements carefully as there may be benefits from early adoption.

2. EXISTING GUIDANCE AND THE RATIONALE FOR CHANGE

2.1. The IASB's project to replace IAS 39

IAS 39 *Financial Instruments: Recognition and Measurement* has been criticised as difficult to understand, apply and interpret. To address these observations, and in response to the global financial crisis of 2008/2009, the International Accounting Standards Board (IASB) embarked on a comprehensive project to replace IAS 39 with a new financial instruments standard IFRS 9 *Financial Instruments*. The project was divided into three phases:

- Phase I: Classification and measurement
- Phase II: Impairment of financial assets
- Phase III: Hedge accounting.

The first phase of the project dealt with classification and measurement of financial assets and financial liabilities. Financial assets were dealt with as part of this first phase, with IFRS 9 being issued in November 2009. This was supplemented in October 2010 by accounting requirements for financial liabilities. In November 2012, the IASB decided to reconsider limited aspects of accounting for financial assets and issued Exposure Draft ED 2012/4 *Limited Improvements to IFRS 9*. For more information on this exposure draft, please refer to BDO's publication *Need to Know – Classification and Measurement: Limited amendments to IFRS 9*, which is available from the IFRS section of our website (www.bdointernational.com) at the link below:

<http://www.bdointernational.com/Services/Audit/IFRS/Need%20to%20Know/Documents/Need%20to%20Know%20-%20Classification%20and%20Measurement%20%28IFRS%209%29.pdf>

The second phase of the project dealt with impairment of financial assets. The IASB is currently developing an impairment model to replace the 'incurred loss' model in IAS 39. In March 2013, the IASB released an ED proposing a three-stage credit deterioration model for impairment. At the date of this publication, the IASB is in the process of redeliberating the comments received from the March 2013 exposure draft. For more information on the impairment Exposure Draft, please refer to BDO's publication *Need to Know – Financial Instruments: Expected Credit Losses (Exposure Draft)*, which is available from the IFRS section of our website (www.bdointernational.com) at the link below:

<http://www.bdointernational.com/Services/Audit/IFRS/Need%20to%20Know/Documents/BDO%20Need%20to%20Know%20-%20FI%20Expected%20Credit%20Losses%20ED%20%28print%29.pdf>

The hedge accounting model in IAS 39 has been criticised as being complex, rules based, and failing to reflect risk management activities of organisations. Some consider that it causes profit or loss volatility from what might be regarded as 'artificial' hedge ineffectiveness which is not representative of the entity's risk management activities. To improve financial reporting and better reflect risk management activities the IASB decided that comprehensive changes were needed.

The IASB decided to split the hedge accounting phase into two separate work streams due to the complexity of the topic:

- General hedge accounting – for one-to-one or 'static' hedge relationships, and
- Macro hedge accounting model – for dynamic hedging relationships of portfolios of financial assets and financial liabilities where the hedged position changes constantly.

2.2. General hedge accounting model

The general hedge accounting model applies to 'static' or 'closed' hedging relationships. This is where the designated volumes of hedged item and the hedging instrument do not change frequently once the hedge is set up and documented. The general model can also be applied to more dynamic hedging relationships, such as those managed on a delta-neutral basis, in which the quantity or amount of the hedging instrument is altered in order to maximise hedge effectiveness.

In December 2010, the IASB issued Exposure Draft *Hedge Accounting* (the ED) on the general hedge accounting model and solicited feedback from preparers and users through an extensive outreach programme and comment letter process. A few concerns and requests for clarifications were raised but, overall, the ED was largely well received by constituents.

During redeliberations, the Board made some changes to the model in the ED in response to concerns raised during the outreach programme and in comment letters. However, the Board did not consider the changes to be so significant as to warrant re-exposure and so the model set out in the ED remains largely intact. In 2012, the IASB decided to post on its website a review draft of the final requirements so that constituents could familiarise themselves with the document before it was issued in its final form.

After the review draft was made available, some specific concerns were raised on particular aspects of the new model. This resulted in some changes being made to parts of the model before the final standard was issued in November 2013.

A table setting out a high level summary of the main changes in the new requirements compared to IAS 39 is provided in section 15 appendix A.

Whilst there are some fundamental changes to the hedge accounting model, the general accounting mechanics of hedge accounting under IAS 39 remain largely unchanged. More specifically:

- The new model retains the cash flow, fair value, and net investment hedge accounting models
- Entities are still required to measure hedge effectiveness and recognise any ineffectiveness in profit or loss
- Hedge documentation is still required
- Hedge accounting will remain optional.

2.3. Macro hedge accounting model

Financial institutions such as banks often use a macro-hedging strategy to manage their interest rate risk exposure of a portfolio of financial assets and liabilities e.g. hedging the net position of fixed rate financial assets and fixed rate financial liabilities.

Under a macro-hedging model, the amounts of both the hedging instrument and the hedged item change constantly (on a daily, hourly or a more frequent basis). The IASB is currently still deliberating on the macro hedge accounting model and is expecting to publish a discussion paper in the first half of 2014. The rest of this publication focuses on the final general hedge accounting model that has been incorporated into IFRS 9 (2013).

3. OBJECTIVE OF HEDGE ACCOUNTING

The objective of the new hedge accounting model in IFRS 9 *Financial Instruments* is to present, in the financial statements, the effect of an entity's risk management activities that use financial instruments and how those financial instruments are used to manage risk.

BDO comment

The International Accounting Standard Board (IASB) has fundamentally reconsidered the purpose and objective of hedge accounting and decided that the objective of hedge accounting should be to reflect the effects of risk management activities in the financial statements.

As a result, the IASB has broadened the application of hedge accounting to include many more risk management activities in IFRS 9. As a result of this, there is the potential for entities significantly to reduce reported profit or loss volatility through economic hedging activities and the application of hedge accounting.

4. EFFECTIVENESS TESTING

The 80-125% quantitative threshold criterion for applying hedge accounting under IAS 39 *Financial Instruments: Recognition and Measurement* has been removed.

To qualify for hedge accounting under IFRS 9 *Financial Instruments* the hedge must meet all of the following criteria:

- i. An economic relationship exists between the hedged item and the hedging instrument – meaning that the hedging instrument and the hedged item must be expected to have offsetting changes in fair value.

For example, an Entity with a Sterling functional currency might sell goods or services to customers that use US dollars. If the Entity entered into a forward contract to exchange US dollars for Sterling on a specified future date (to coincide with the expected date of US dollar payments by customers), changes in the fair value of that forward contract would be expected to offset changes in the fair value of cash to be collected that is denominated in US dollars.

- ii. The effect of credit risk does not dominate the fair value changes – i.e. the fair value changes due to credit risk should not be a significant driver of the fair value changes of either the hedging instrument or the hedged item.

The hedge ratio is required to be designated based on actual quantities of the hedged item and hedging instrument (unless doing so would create deliberate hedge ineffectiveness) – i.e. the hedge ratio applied for hedge accounting purposes should be the same as the hedge ratio used for risk management purposes.

For example, an Entity enters into a CU10m pay-fixed-receive-floating interest rate swap to manage its exposure to floating interest arising from CU10m floating interest rate loan. The Entity would designate the following:

- Hedged item: CU10m floating interest rate loan
- Hedging instrument: CU10m pay-fixed-receive-floating interest rate swap.

BDO comment

The hedge effectiveness testing criteria under IAS 39 includes a requirement that the hedge relationship must meet the 80-125% quantitative threshold both retrospectively and prospectively. This requirement is restrictive, operationally onerous, and has prevented many economic hedging relationships from qualifying for hedge accounting.

*The removal of the 80-125% quantitative threshold means that even if at the end of a reporting period the hedge was only 70% effective, the Entity would recognise 30% of ineffectiveness in profit or loss but **would not** discontinue hedge accounting.*

In contrast, under the IAS 39 model the Entity would have to discontinue hedge accounting because retrospective effectiveness of 70% is not within the 80-125% range.

Under the new requirements, in order to qualify for hedge accounting only prospective hedge effectiveness testing is required.

- i. For simple hedge relationships, entities are expected to be able to apply a qualitative test (e.g. critical terms match where the risk, quantity and timing of the hedged item matches the hedging instrument).
- ii. For more complex hedging relationships, such as where the hedged item is of a different grade to the hedging instrument (e.g. where a basis difference exists) a more detailed quantitative test is likely to be required.

The new requirements in IFRS 9 may lead to entities having to exercise additional judgement in practice for complex hedges. This may include:

- Establishing an appropriate hedge ratio
- Establishing whether or not an economic relationship exists
- Determining whether a quantitative test should be applied or whether a qualitative test is sufficient.

BDO comment

For simple vanilla interest rate swap and for foreign exchange hedges in which the currency, amounts, maturity and other critical terms match, it is expected that the new requirements will be simpler to apply and make qualifying for hedge accounting easier.

5. REBALANCING

Rebalancing is a new concept introduced by the hedge accounting requirements of IFRS 9 *Financial Instruments*.

Rebalancing refers to the prospective alteration of the hedge ratio (either by changing the quantities of the hedged item or the hedging instrument) without discontinuing/terminating the existing hedge accounting relationship.

The new model requires rebalancing when there is a change in the economic relationship between the hedged item and the hedging instrument such that it leads to an adjustment of the economic hedge ratio.

Example 1: Rebalancing

Entity A enters into a commodity derivative to hedge its exposure to the related commodity price. However, the commodity that Entity A hedges is of a higher grade than the reference underlying commodity of the derivative.

At the start of the hedge, the price differential between the two grades is 20% and (to maximise offset) Entity A sets hedge ratio of 0.8 (0.8 hedged item to 1 derivative).

Three months later, due to supply and demand factors, the price differential between the two grades has increased to 30%.

To maximise offset, the Entity 'rebalances' and takes out additional (offsetting) derivatives so that the hedge ratio is now 0.7 (0.7 hedged item to 1 derivative).

NOTE: Prior to rebalancing (i.e. before adjusting the updated quantities), ineffectiveness would have to be measured and recognised in profit or loss in accordance with the previous quantities of the hedged item and hedging instrument.

BDO comment

*When an Entity changes the hedge ratio for risk management purposes (as a result of a change in the economic relationship between the hedged item and hedging instrument), IAS 39 **does not** permit entities to adjust the quantities designated in the hedge relationship. When the economic hedge ratio changes for risk management purposes, under IAS 39, entities would have to terminate the existing relationship and establish a new relationship.*

The concept of 'rebalancing' links the accounting requirements more closely to risk management as, economically, risk managers typically adjust their hedge positions for any changes in the economic relationship between the hedged item and the hedging instrument so as to improve hedge effectiveness (i.e. to achieve greater offset), particularly if the hedging relationship extends for a number of years.

6. HEDGED ITEMS

The new hedging model under IFRS 9 *Financial Instruments* allows more items to qualify as eligible hedged items in comparison with IAS 39 *Financial Instruments: Recognition and Measurement*.

6.1. Risk components as hedged items

Under IAS 39, risk components of financial items (e.g. hedging the benchmark component (e.g. LIBOR) of a floating rate loan) are already eligible hedged items.

This is because IAS 39 permits an identifiable and separately measurable component of a financial asset or liability to be a hedged item. However, this does not extend to non-financial items, for which only a foreign exchange component can be separated. This is because it was considered to be too difficult to isolate and measure cash flows relating to different risks.

In contrast, the new hedge accounting model in IFRS 9 aligns the requirements of financial and non-financial items such that risk components of non-financial items can also be eligible hedged items.

To be an eligible risk component, the risk component needs to be separately identifiable and reliably measurable. The eligible risk component can be contractually or non-contractually specified. If the risk component is non-contractually specified, then in order to assess whether it meets the separately identifiable and reliably measurable criteria an analysis of the linkage of between the risk component and the hedged item in that particular market structure is required i.e. how the particular risk affects the fair value of the hedged item.

BDO comment

Treasurers and risk managers often manage risk by individual risk rather than the item as a whole. Allowing risk components of non-financial items to qualify as hedged items better reflects risk management activities in practice.

From an accounting perspective, allowing non-financial risk components to be eligible hedged items means that, when measuring hedge effectiveness (i.e. the degree of offset), entities can compare changes in the fair value of the hedging instrument (e.g. derivative) with changes in the fair value of the particular risk rather than the whole item, thereby achieving greater degree of offset (and hence hedge effectiveness) with a corresponding reduction in profit or loss volatility.

Example 2: Contractually specified risk component

Entity A enters into contracts to purchase 100 tonnes of coffee in 6 months' time. The contract price for the coffee is based on the pricing formula: Coffee C ICE futures + 5% logistics fee. Entity A enters into Coffee C ICE futures contracts to hedge the variability in coffee price.



Illustration 1: Pricing formula of the coffee price contract

Under IFRS 9, the Coffee C ICE future can be separately identified as a contractually specified component of the pricing contract, meaning that Entity A can designate the coffee C ICE futures component of the contract price as a hedged item. This means that Entity A will compare changes in the fair value of the coffee futures component in the contract price (hedged item) with the changes in the fair value of the coffee futures derivative that it has taken out (hedging instrument).

If all other factors matched (such as the timing of the purchase and maturity of the coffee C ICE futures), 100% hedge effectiveness would result.

In contrast, under IAS 39, because the hedge accounting requirements do not permit the designation of risk components in non-financial items, Entity A would only be able to designate the purchase coffee contract in its entirety as the hedged item. The effects of the hedge are the same as outlined in Example 2 above. This would result in hedge ineffectiveness being recorded in respect of movements in the fair value of the logistics fee component.

Example 3: Non-contractually specified risk component

Entity B enters into Coffee C ICE futures contracts to hedge its highly probable forecast coffee purchase in two years time.

There is no contractually specified risk component, as the purchase contracts have not yet been signed, however, the Entity knows from past experience that the purchased contracts will be priced based on the pricing formula:

Coffee C ICE futures + 5% logistics fee.

Therefore it concludes that the Coffee C ICE futures price is a risk component of the forecast coffee purchases.

Under IFRS 9, Entity B can designate the Coffee C ICE futures component of those forecast future purchases as an eligible hedged item.

Example 4: Non-contractually specified risk component

Entity A enters into contracts to purchase jet fuel. The market structure of jet fuel price includes crude oil price as an identifiable component (see illustration below). To hedge the variability in crude oil prices, Entity A enters into crude oil futures.

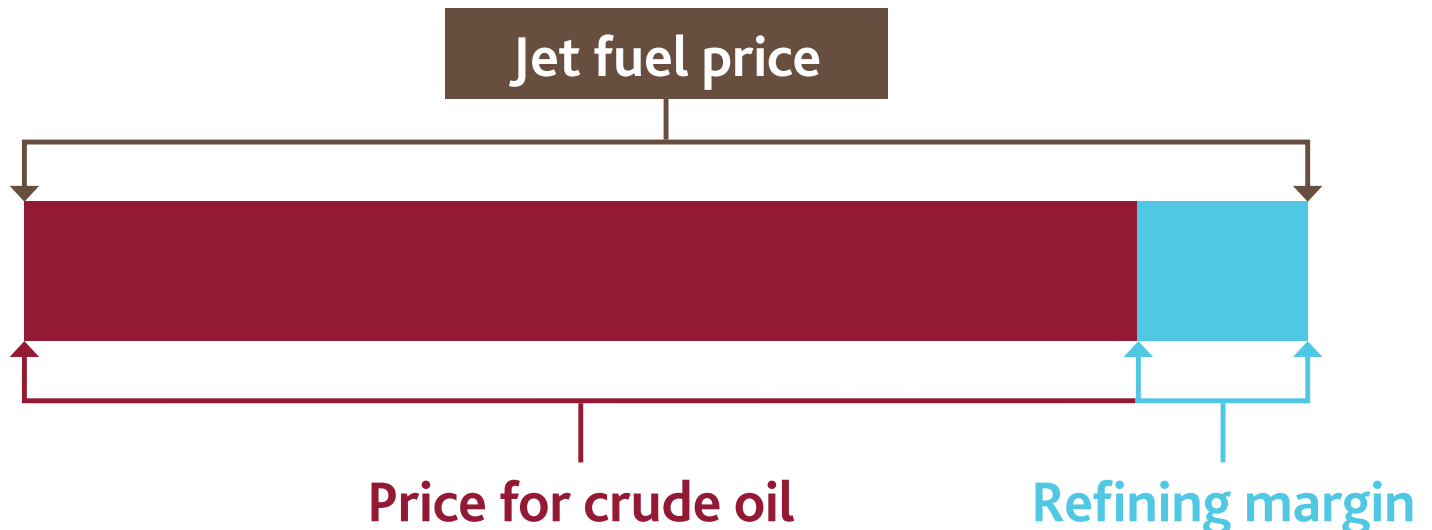


Illustration 2: Risk components of price of jet fuel

Under IFRS 9, Entity A can designate the crude oil component of the jet fuel price as a hedged item because the market structure for jet fuel prices is such that crude oil is a building block of jet fuel prices.

This means that Entity A compares changes in the fair value of crude oil futures with changes in the fair value of crude oil, giving Entity A greater offset than under the IAS 39 model. Under IAS 39, Entity A could only designate the changes in the crude oil futures against the entire jet fuel price, which results in hedge ineffectiveness (this can be large enough to prevent the hedging relationship falling within the 80-125% range and can therefore prevent hedge accounting).

BDO comment

As the examples above illustrate, identifying a contractually specified risk component can be relatively straightforward. However identifying a non-contractually specified risk component in non-financial items often involves more judgement and analysis. Such an analysis may involve discussions with the sales or purchasing departments in order to obtain details about how an item is priced within a particular market and how the value of the related risk components can be reconciled to the price of the item.

6.2. Aggregated exposures

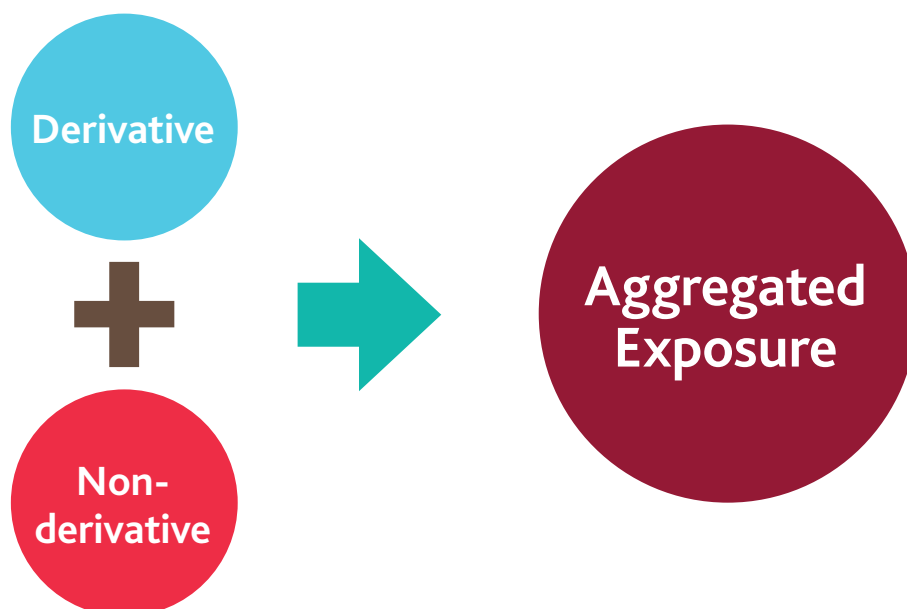


Illustration 3: Aggregated exposure

Aggregated exposure is another new term introduced by IFRS 9.

An aggregated exposure is a combination of a derivative item and a non-derivative item.

Under IAS 39, derivatives cannot be designated as hedged items, meaning that when an Entity manages its overall risk exposure by entering into offsetting derivative contracts, from an accounting perspective the hedge needs to be de-designated and redesignated each time a new derivative contract is entered into during the term of the hedge.

This gives rise to complexity and, due to the designation of existing derivatives which do not have a zero fair value at the date of designation, hedge ineffectiveness.

IFRS 9 allows an Entity to designate an exposure that combines a derivative and a non-derivative (an aggregated exposure) as a hedged item, provided that the aggregated exposure is managed as one exposure.

Example 5: Aggregated exposures – FX and interest rate risk

Entity C is based outside the US with a Local Currency (LC) as its functional currency, and issues private placement bonds in the US with a maturity of 10 years and a fixed interest rate of 5%.

To manage the foreign exchange risk from US dollars (USD) denominated debt, Entity C enters into a 10 year cross-currency interest rate swap (CCIRS). The CCIRS pays floating interest rate payments in LC and receives fixed USD interest payments.

Entity C's interest rate risk management strategy subsequently changes, to require fixed interest rates from year two to year five in its local currency.

Therefore, Entity C enters into a second derivative instrument, being an interest rate swap which pays fixed interest payments and receives floating interest payments in LC.

The effect is that the local floating interest payments in years two to five are swapped to fixed interest LC payments.

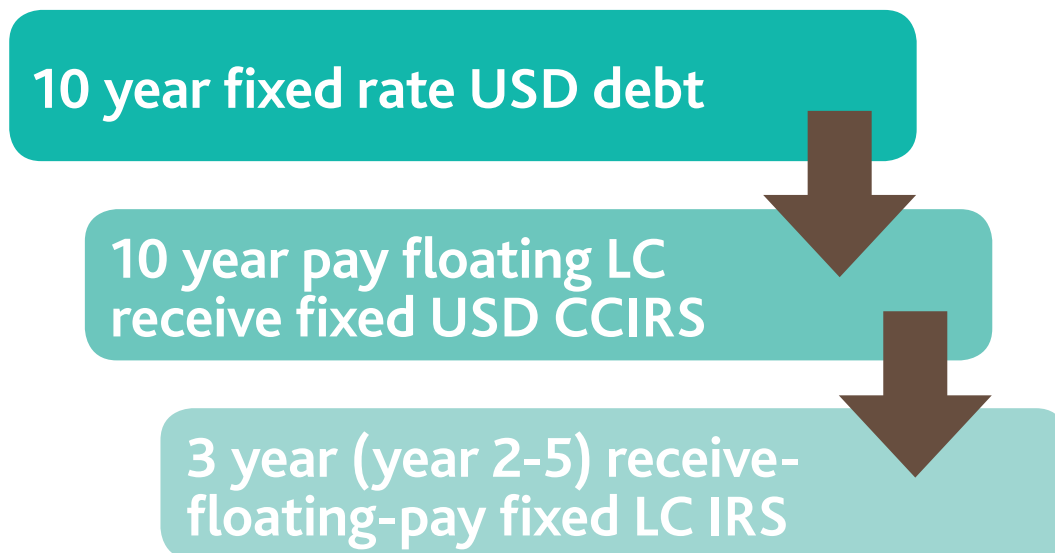


Illustration 4: Hedged items and hedging instruments

Under IFRS 9, Entity C would be able to designate the following relationships:

- i. First hedging relationship – to mitigate the exposure to foreign exchange (FX) risk:
 - Hedged item: 10 year fixed rate USD debt
 - Hedging instrument: 10 year CCIRS.
- ii. Second hedging relationship – to mitigate the exposure to local interest rates risk in years two to five:
 - Hedged item: floating interest rate payments (years two to five) – the aggregated exposure
 - Hedging instrument: pay fixed receive floating interest rates in its local currency.

This means that when Entity C wants to fix its floating rate exposure in its local currency from years two to five by entering into a three-year receive-floating-pay-fixed interest rate swap (IRS), under IFRS 9 Entity C treats the combined exposure of the debt and CCIRS (termed the 'aggregated exposure') as a hedged item and establishes a second hedging relationship for years two to five.

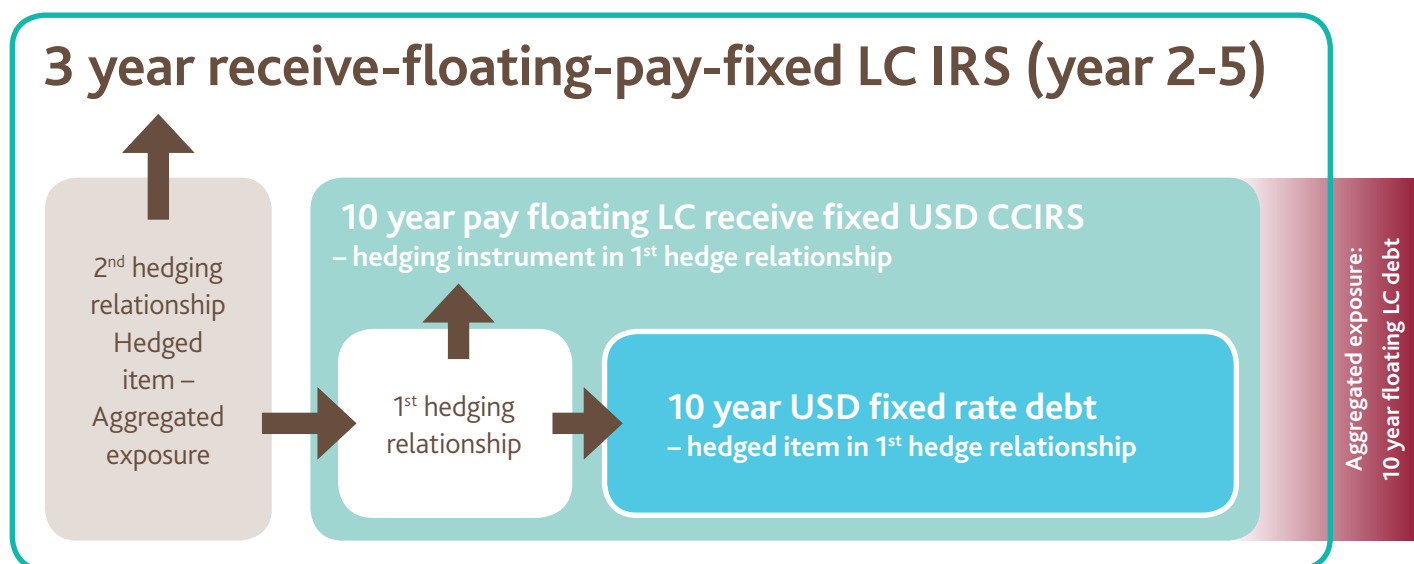


Illustration 5: Hedge relationships established under the new requirements

BDO comment

IAS 39 permits entities to jointly designate the two derivatives (i.e. the IRS and the CCIRS) against the debt.

However, IAS 39 **prohibits** entities from designating the second hedge relationship because designating a derivative as a hedged item is not permitted.

This is a problematic area in practice under IAS 39 as most entities manage their foreign exchange risk and interest rate risk separately. If entities also want to designate the IRS in the hedging relationship from year 2, under IAS 39 entities would have to terminate the original hedging relationship and then establish a new hedging relationship and jointly designate the IRS and CCIRS as hedging instruments. Because the CCIRS will have a non-zero fair value on this subsequent designation, hedge ineffectiveness will result and entities might fail the 80-125% effectiveness testing requirement.

Aggregated exposures can also arise in commodity contracts that are denominated in a foreign currency.

Example 6: Aggregated exposures – commodity and foreign exchange risk

Entity D is based outside the US with a Local Currency (LC) as its functional currency.

Entity D enters into a contract to purchase coffee in three years time in USD.

To manage the variability in coffee prices Entity D also enters into a three year USD coffee future.

Because the entity's functional currency is not USD, it is also exposed to USD foreign exchange risk (FX risk).

To manage the FX risk, Entity D enters into an foreign exchange contract for two years (a three year contract is not entered into, because Entity D is expecting receipts of US dollars at the end of year two from another source).



Illustration 6: Hedged items and hedging instruments

Under IFRS 9, Entity D would establish **two** hedging relationships:

- i. First hedging relationship – to lock in the **coffee price** in three years time:
 - Hedged item: USD coffee purchase in three years time
 - Hedging instrument: 3 Year coffee futures in USD.
- ii. Second hedging relationship – to lock in the **USD currency exposure** for two years:
 - Hedged item: USD outflow in two years time (the aggregated exposure)
 - Hedging instrument: 2 year USD/LC FX contract.

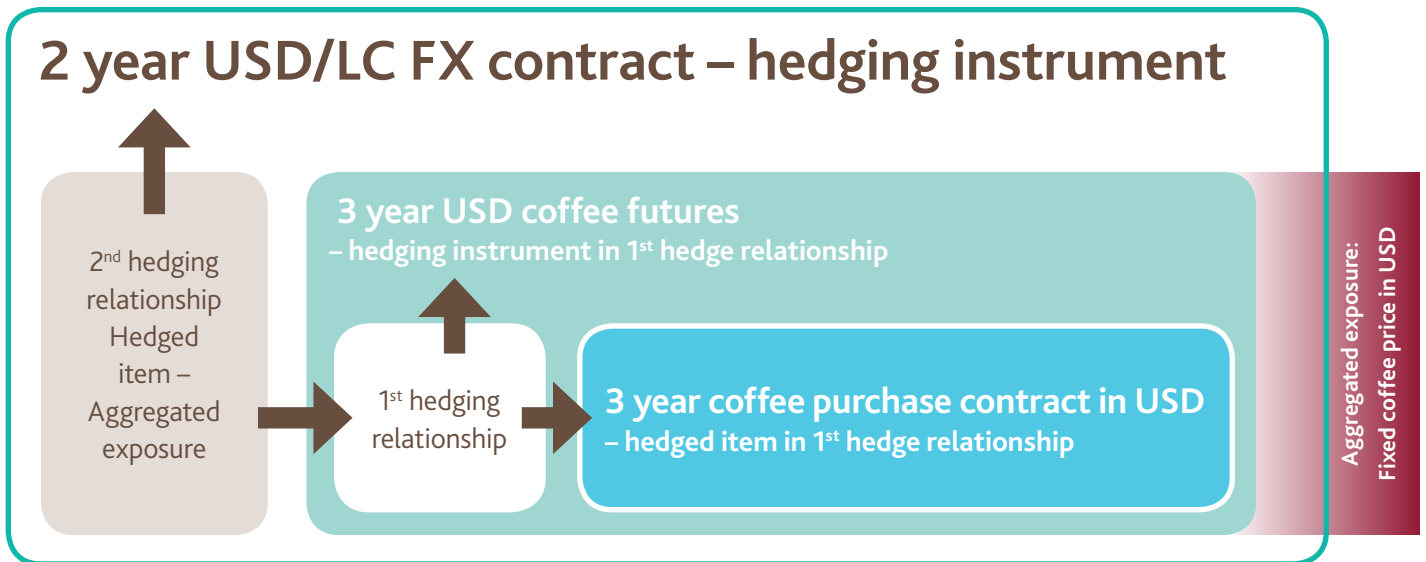


Illustration 7: Hedge relationships established under the new requirements

BDO comment

By allowing aggregated exposures to qualify as eligible hedged items, the new model enables entities to achieve hedge accounting more easily when they manage multiple risks separately as part of their risk management strategy. This permits entities to better reflect their risk management activities in the financial statements.

6.3. Equity investments at FVTOCI

Under IFRS 9, entities can make an irrevocable choice on initial recognition to classify equity investments to the fair value through other comprehensive income (FVTOCI) category.

Under the FVTOCI category, all fair value gains and losses are recognised in other comprehensive income (OCI) rather than profit or loss – with the exception of dividends (other than to the extent these represent the recovery of part or all of the cost of the investment).

The FVTOCI category under IFRS 9 is also eligible for hedge accounting – i.e. it can be designated as a hedged item.

Under the FVTOCI category, all fair value gains and losses are recognised in other comprehensive income (OCI) while dividends received are recognised in profit or loss (however, to the extent that they represent the recovery of part (or all) of the cost of the investment, dividends received are recognised in OCI).

Example 7: Equity investments at FVTOCI

On 1 January 20X4, Entity E purchased 100 shares in ABC Ltd for CU100, a listed company.

Entity E elects to account for the shares at FVTOCI.

To hedge the changes in fair value of the shares, Entity E enters into market index futures (because experience from the past few years shows that the share price of ABC Ltd moves in line with the market index).

On 31 March 20X4, the share price of ABC Ltd is CU1.20 (fair value increase of CU20 for 100 shares).

The movement in fair value of the market index futures is CU(18).

The journal entries at 1 January and 31 March 20X4 are as follows:

1 January 20X4

Dr	Equity investment at FVTOCI	CU100	
	Cr Cash		CU100

Being the purchase of 100 shares in ABC Ltd for CU100.

31 March 20X4

Dr	Equity investment at FVTOCI	CU20	
	Cr OCI		CU20
Dr	OCI	CU18	
	Cr Derivative liability		CU18

Being the changes in fair value of the equity investments (hedged item) and the derivative (hedging instrument) in OCI.

BDO comment

In ED 2012/4 Classification and Measurement: Limited Improvements to IFRS 9, the IASB proposed the introduction of a third measurement category for debt instruments (FVTOCI). If that measurement category is added to IFRS 9, the IASB is expected to consider the associated effects on whether that category is also eligible for hedge accounting.

7. HEDGING INSTRUMENTS

7.1. Options

The value of an option contains an *intrinsic value* component and a *time value* component.

Intrinsic value is the difference between the option exercise price and the spot price.

Time value is the residual difference between the option's total fair value, less its *intrinsic value*.

For example, an entity acquires a call option to buy gold at CU1,000, at which point the spot price is CU1,100. The option has an intrinsic value of CU100. If the fair value of the option is CU150, then the time value of the option is CU50 (i.e. CU150 - CU100).

When using an option as a hedging instrument, IAS 39 *Financial Instruments: Recognition and Measurement* allows entities to designate either the whole contract, or only the intrinsic value of the option, as the hedging instrument. If the entire contract is designated as the hedging instrument, hedge ineffectiveness normally results because the related hedged item typically does not have a time value component. If only the intrinsic value of the option is designated as the hedging instrument, although hedge effectiveness may be improved, all changes in the time value component of the option will be recorded in profit or loss (this component will be accounted for at fair value through profit or loss, in the same way as a derivative that is not designated in a hedging relationship). This introduces profit or loss volatility from the change in the time value over the life of the option.

Under IFRS 9 *Financial Instruments*, an entity can continue to designate only the intrinsic value of the option as the hedging instrument, but the changes in time value will be recorded in other comprehensive income (OCI) instead of profit or loss, meaning that profit or loss volatility will be reduced.

The option's time value at initial recognition is then accounted for as follows:

- i. If the hedged item is transaction related (for example, a forecast purchase of commodity), the initial time value is deferred in OCI and capitalised into the cost of the hedged item.
- ii. If the hedged item is time period related (for example, it is an interest rate cap), the initial time value is deferred in OCI and amortised to profit or loss over the term of the hedging relationship.

Hedged item	Initial time value	Example
Transaction related	Capitalise into the cost of the hedged item.	A commodity put option to hedge forecast sales of a commodity. A foreign exchange call option to hedge the forecast purchase of a machine in foreign currency.
Time period related	Amortise over the term of the hedging relationship.	Interest rate cap on a floating interest rate loan.

Illustration 8: Accounting for the time value of options under the new model when only the intrinsic value is designated as the hedging instrument

The following charts show examples of how the time value component of the option can change over the life of the option. The time value component will always be zero at option expiry date (at which point the option can have only intrinsic value). As noted above, under IFRS 9 changes in time value will now be recorded in OCI.

Time value of options – transaction related hedged item

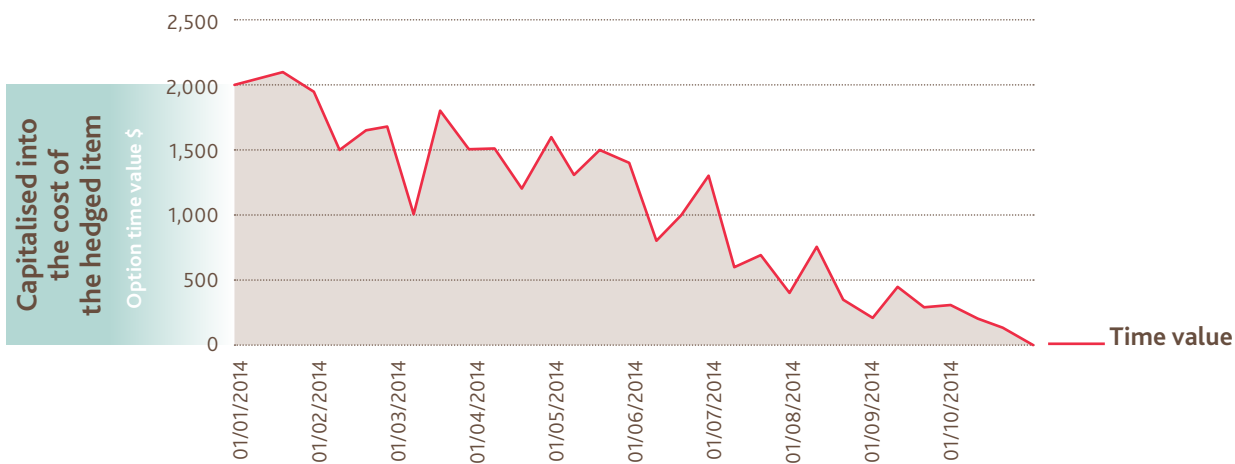


Illustration 9: The changes in time value of options and the treatment of initial time value for transaction related hedged items

Time value of options – time period related hedged item

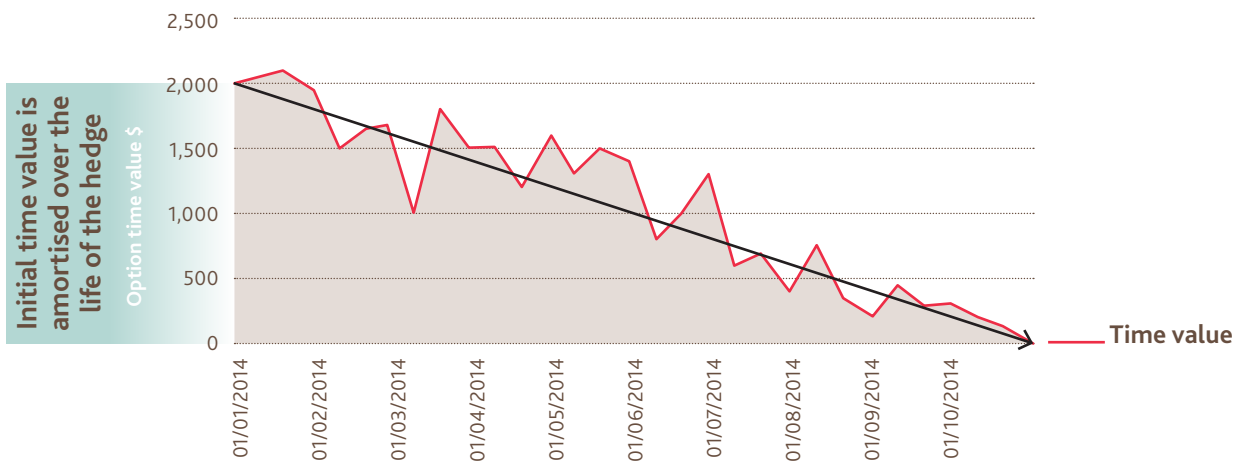


Illustration 10: The changes in time value of options and the treatment of initial time value for time period related hedged items

Example 8: Time value of options – transaction related hedged item

- Entity X is a copper producer and enters into a put option to hedge sales that are forecast to take place on 30 September 20X4
- On 1 January 20X4 Entity X enters into a put option to sell 1,000 tonnes of copper for CU50/tonne. The put option expires on 30 September 20X4 (assume that the hedge is 100% effective)
- The copper spot price on 1 January 20X4 is CU50/tonne
- Entity X pays CU2,000 for the put option
- Initial time value (i.e. fair value; less, intrinsic value) is CU2,000.
[i.e. CU2,000 – ((CU50-CU50) x 1,000 tonnes)]

1 January 20X4

Dr	Option	CU2,000	
	Cr Cash		CU2,000

To recognise the purchase of the option.

Subsequently, on 1 March 20X4:

- The fair value of the option is CU5,000
- The copper spot price is CU46/tonne
- Intrinsic value is CU4,000
[i.e. (CU50-CU46) x 1,000 tonnes]
- The time value of the option (i.e. fair value; less, intrinsic value) is CU1,000
[i.e. CU5,000 – CU4,000].

1 March 20X4

Dr	Option	CU3,000	
Dr	OCI – Option time value reserve	CU1,000	
	Cr OCI – Cash flow hedge (CFH) reserve		CU4,000

To recognise the change in fair value of the option, taking the change in the intrinsic component (the hedging instrument) to the CFH reserve, and recognising the change in time value in the option time value reserve.

Subsequently, on 30 September 20X4:

- The fair value of the option is CU10,000
- The copper spot price is CU40/tonne
- The time value of the option is CU0
- 1,000 tonnes of copper is sold at the spot rate.

30 September 20X4 – Journal 1

Dr	Trade receivable	CU40,000	
	Cr Sales revenue		CU40,000

To recognise sales of 1,000 tonnes of copper at spot rate of CU40/tonne.

30 September 20X4 – Journal 2

Dr	Option	CU5,000	
Dr	OCI – Option time value reserve	CU1,000	
	Cr Cash flow hedge (CFH) reserve		CU6,000

To recognise the change in fair value of the option, taking the change in the intrinsic component (the hedging instrument) to the CFH reserve, and recognising the change in time value in the option time value reserve.

30 September 20X4 – Journal 3

Dr	OCI – CFH reserve	CU10,000	
Dr	Sales	CU2,000	
	Cr Sales		CU10,000
	Cr OCI – Option time value reserve		CU2,000

To reclassify the amount in the CFH reserve and the option time value reserve against sales revenue.

Calculation of copper sales revenue

Copper sales at spot rate	CU40,000
Gain or loss recycled from cash flow hedge reserve	CU10,000
Initial time value of option	CU(2,000)
Total	CU48,000

Illustration 11: Adjustments to sales revenue from hedging copper sales using copper put option

Example 9: Time value of options – time period related hedged item

- Entity X enters into a 5 year interest rate option to cap the interest rate on its 5 year floating rate loan at 8%
- Entity X paid CU2,000 for the interest rate cap (assume the interest rate cap is at the money and therefore it has a zero intrinsic value at initial recognition)
- Under IFRS 9, the initial time value of CU2,000 will be amortised over 5 years to profit or loss. Subsequent changes in time value are recognised in OCI.

BDO comment

Note that only the change in time value to the extent that it relates to the hedged item can be recognised in OCI.

It is only if the critical terms of the option (i.e. nominal amount, expiry date and the underlying) match the hedged item that all of the changes in time value after initial recognition can be recognised in OCI and the entire initial time value deferred.

If the critical terms of the option and the hedged item do not match, the cumulative difference between the time value of the option and the aligned time value (i.e. the time value that perfectly matches the hedged item) is taken to profit or loss.

7.1.1. Zero cost collars

Entering into options results in increased costs for an entity, just as buying insurance will cost money.

To reduce costs, it is not uncommon for entities to enter into 'zero cost collars' which are essentially a combination of a purchased option, and a written option. The strike prices of the two options are set such that the premium the entity would pay for the purchased option component exactly offsets the premium the entity would have received for the written option component. This results in a net premium of zero (hence the reference to 'zero cost').

Although the initial net time value may be zero¹, during the period to maturity the time value of the purchased and written option components will fluctuate and are unlikely to offset each other.

The accounting for the time value of options under IFRS 9 also applies to time value arising from zero cost collars. This means that entities are able to recognise the subsequent changes in time value in OCI for those instruments.

The graph below illustrates the fair value changes of a zero cost collar.

- i. Under IAS 39, the changes in time value result in profit or loss volatility
- ii. Under IFRS 9, if the entity hedge accounts and all critical terms of the hedged item and hedging instrument match, the resulting volatility will be recorded in OCI instead.

Time value of zero cost collars

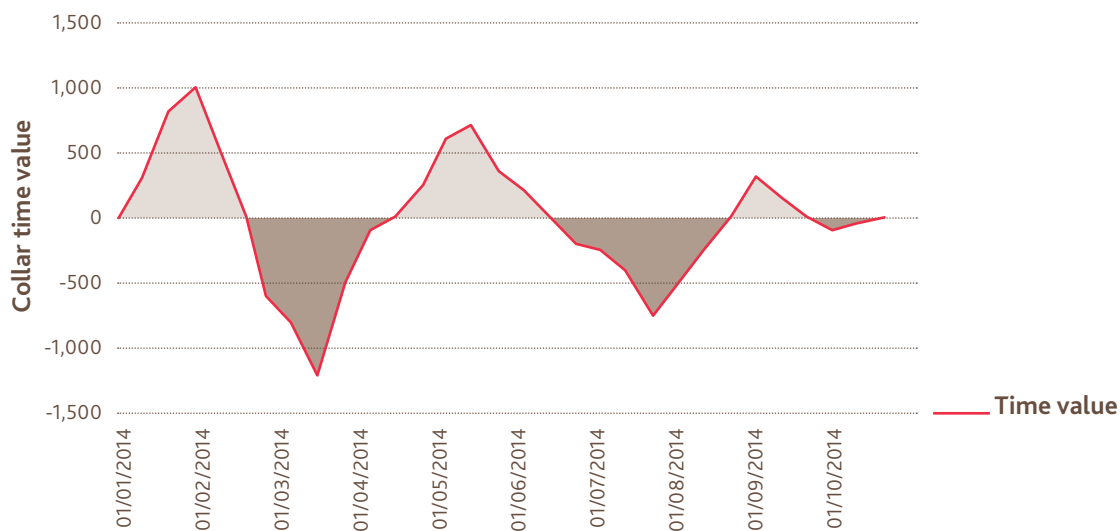


Illustration 12: Changes in time value component – zero cost collars

¹ Assuming that the options are at the money and therefore the initial premiums represent the option's time value.

7.2. Forwards

Forward instruments have a spot component and a forward points component.

The characteristics of the forward points are different depending on the underlying.

For example, for foreign currency forwards, the forward points represent the interest rate differential between the two currencies, and for commodity forwards the forward points reflect storage and other costs (often referred to what is called the 'cost of carry').

In the same way as for options, IAS 39 allows an entity to designate either the whole contract, or only the spot element of the forward, as the hedging instrument.

- i. If the entire contract is designated as the hedging instrument, hedge ineffectiveness can result due to the effect of the forward points where the hedged item is required to be measured at the spot rate.
- ii. If only the spot component is designated as the hedging instrument, hedge effectiveness may be improved as the hedging instrument will be a better offset of changes in the fair value of the hedged item. However, the changes in the forward points will be recognised in profit or loss.

Under IFRS 9, when an entity designates only the spot component of the forward as the hedging instrument, the entity is permitted to recognise the changes in the forward points in OCI and amortise the fair value of the forward points on initial recognition of the forward contract over the term of the hedging relationship. This reduces profit or loss volatility.

Example 10: Forward points

Entity X lends FC1,000 in foreign currency to one of its suppliers.

Entity X takes out a foreign exchange forward contract (FX forward contract) to offset the spot foreign exchange movements related to the loan between the foreign currency and its functional currency.

Under IAS 21 *The Effects of Changes in Foreign Exchange Rates*, Entity X is required to remeasure the loan at spot rate.

To improve hedge effectiveness, Entity X designates only the spot element in the FX forward contract to offset the changes in the spot foreign exchange prices of the loan.

Under IFRS 9:

- Changes in fair value of the forward points can be recognised in OCI
- The fair value of the forward points on initial recognition of the forward contract will be amortised over the period of the hedge.

Accounting under IFRS 9	
Foreign currency loan (Hedged item)	Changes in spot FX to profit or loss (IAS 21)
Foreign currency forward (Hedging instrument)	Changes in spot FX to profit or loss Changes in forward points to OCI

Illustration 13: Accounting treatment under IFRS 9

BDO comment

Like options, note that only the change in the forward points to the extent that this component relates to the hedged item can be recognised in OCI.

It is only if the critical terms of the forward (i.e. nominal amount, expiry date and the underlying) match the hedged item, that all of the subsequent changes in value can be recognised in OCI and the entire initial forward points deferred.

If the critical terms of the forward contract and the hedged item do not match, the cumulative difference between the fair value of the forward points of the forward contract and the aligned forward points fair value (the forward points value that perfectly matches the hedged item) is taken to profit or loss.

7.3. Foreign currency swaps and basis spread

Foreign currency (FX) basis spread is a pricing element in foreign currency swaps (e.g. foreign currency interest rate swaps) that reflects the 'cost' of exchanging two currencies. It arises mainly due to the supply and demand for different currencies and the perceived credit risk of different reference rates/main players (large financial institutions) in the FX market. The FX basis spread results in volatility in the fair value of the hedging instrument (especially in recent times) which does not exist in the hedged item. This results in hedge ineffectiveness.

Under the new model in IFRS 9, entities can apply the same accounting as for forward points to the FX basis spread component of foreign currency swap when designating the foreign currency swap as a hedging instrument. This means that the fair value of the FX basis spread component on initial recognition of the swap can be amortised over the hedging relationship with subsequent changes in the fair value of FX basis spread being recognised in OCI.

BDO comment

Note that, in the same way as for options and forwards as discussed above, the change in fair value of the FX basis spread can only be recognised in OCI to the extent that its critical terms match those of the hedged item (see BDO comment in 7.1 and 7.2 above).

7.4. Cash instruments measured at FVTPL

Under IAS 39, only derivatives can be designated as hedging instruments (with the exception of cash instruments measured at amortised cost which can be designated as hedging instruments for FX). Under IFRS 9, any financial instruments that are measured at fair value through profit or loss (e.g. an investment in a commodity linked note) are eligible hedging instruments. Cash instruments can continue to be eligible hedging instruments for FX risk.

However, note that financial liabilities which are designated at fair value through profit or loss under the fair value option and for which changes in fair value attributable to the entity's own credit risk are recognised in OCI are not eligible hedging instruments.

8. HEDGES OF GROUPS AND NET POSITIONS

IAS 39 *Financial Instruments: Recognition and Measurement* contains very restrictive rules on hedge accounting for groups of items:

- It requires that each individual item in the group has value changes on the hedged risk that are approximately proportional to that of the group as a whole e.g. a portfolio of shares cannot be designated as a group against a market index derivative because the individual shares do not necessarily move in the same direction as the market index
- It does not allow entities to hedge net positions, when risks within the group naturally offset to some degree so that from a commercial perspective only the remaining net risk is hedged.

The requirements in IFRS 9 *Financial Instruments*:

- Remove the IAS 39 proportional movement restriction on groups
- Permits fair value hedges of net positions (for example, it is possible to hedge account net foreign currency (FX) cash flows of FC100 that result from FC150 FX committed purchases and FC250 of FX committed sales), and
- Permits cash flow hedge accounting of a net position for foreign exchange risk, with this being conditional on entities specifying at the start of the hedging relationship how and when each of the items that make up the net position will affect profit or loss.

For net position hedges under IFRS 9, any recycling of the hedging instrument gains or losses into profit or loss is presented in a separate line item, and is not adjusted to the related individual line items.

Example 11: Hedges of net FX cash flow position

On 31 March 20X4 Entity E hedges a net FC4m position which comprises the following forecast transactions:

Transactions	FC
Expected sales (spread evenly over the next 6 months)	FC12m
Expected inventory purchases (spread evenly over the next 6 months)	FC6m
Expected machinery purchase (Purchase expected 30 September 20X4)	FC2m

Illustration 14: Entity E's forecast foreign currency transactions during the next 6 months

Entity E enters into a FC4m foreign currency (FX) forward contract which matures on 30 September 20X4 at a rate of 1FC:1LC.

Under IFRS 9, Entity E can designate all cash flows in the table as the hedged item in a single (net position) cash flow hedge and designate the FX forward contract as the hedging instrument.

However, although the hedge is of an overall net position, all of the gross amounts that make up the net position must be identified and designated clearly as the hedged items in the related documentation. The eventual sales and purchases are reflected at the spot rate at the time of the transaction (they are not recorded at the hedged rate). The gain or loss from the FX forward relating to the sales and purchases being recognised in profit or loss for that period is presented on a separate line item in profit or loss. This means that the net profit or loss line item in the statement of profit or loss and other comprehensive income will reflect the hedged rate.

Assuming that the average exchange rate during the three months to, and as at, 30 June 20X4 was 1FC:1.5LC (i.e. Entity E's functional currency has weakened), and that all purchased inventory was sold, the following entries would be recorded:

Extracts from Statement of profit or loss and other comprehensive income

Line items	30 June 20X4
Sales at spot rate ²	LC9m
Cost of sales at spot rate ³	LC(4.5m)
Gain or loss recycled from CFH reserve	LC(1.5m)
Net profit (loss)	LC3m

$$^2 (FC12m / 6 \text{ months} \times 3 \text{ months} \times \text{spot rate}) = 12m / 6 \times 3 \times 1.5$$

$$^3 (FC6m / 6 \text{ months} \times 3 \text{ months} \times \text{spot rate}) = 6m / 6 \times 3 \times 1.5$$

Illustration 15: Effects of applying net FX cash flow hedge provision under IFRS 9 on the Statement of profit or loss and other comprehensive income

The overall effect of the arrangement is that the net profit recorded for the three month period is the same as it would have been if the transactions had not been hedged and the exchange rate had been 1FC:1LC.

BDO comment

Treasurers and risk managers often hedge net risk positions (i.e. allowing the risks within the group to naturally offset each other) in order to reduce the number of hedging instruments entered which lowers transaction and administrative costs. Entities may also take out a number of loans, some at fixed rates and others at floating rates, which have differing maturity dates with interest rate swaps then being taken out and 'layered' to manage the overall mixture of fixed and floating rates to a risk management policy of, for example, 50% fixed rate and 50% floating rate. The new hedge accounting model accommodates this type of risk management by permitting aggregated exposures of non-derivatives and derivatives, and net positions, to be designated as the hedged item.

Under IAS 39, net risk position hedges are not permitted and instead a single hedging relationship must be identified. In the example above, an IAS 39 compliant hedge would involve designating a specified FC4m portion of forecast sales as the hedged item in a cash flow hedge, ignoring the fact that it is actually a result of multiple cash inflows and outflows of that particular foreign currency. In order that the timing of the hedged transactions was sufficiently close to the maturity date of the derivative, the entity might designate the first FC 4m of sales in quarter 3 (July to September) as the hedged item.

9. DISCONTINUATION OF HEDGE ACCOUNTING

The requirements in IFRS 9 *Financial Instruments* restrict the ability to discontinue hedge accounting to circumstances in which the qualifying criteria are no longer met.

In contrast to IAS 39 *Financial Instruments: Recognition and Measurement*, voluntary discontinuation is not permitted. The following circumstances would require hedge accounting to be discontinued:

i. The entity's hedge objective has changed

For example, an entity has a risk management policy to have 40-60% of its borrowings at fixed interest rates. The entity has CU100 of floating rate borrowings, and therefore took out a pay-fixed-receive-floating interest rate swap of CU60 (effectively, it has hedged 60% of its borrowings at fixed rates). Due to the current interest rate environment, the entity's risk management strategy is to now only have 40% of its borrowings at fixed rates, so the entity would discontinue hedge accounting for CU20, but would continue with the existing hedge relationship with the CU40 of borrowings against CU40 of the interest rate swap. The effect is that the hedging relationship would be rebalanced to reflect the new risk management strategy.

Under IAS 39, the whole hedge would have needed to be discontinued, and then the entity would have been permitted to redesignate a new hedge relationship for CU40. However, if it used a proportion of the existing interest rate swap as the hedging instrument (instead of settling the existing swap and entering into a new zero fair value swap) the non-zero fair value of the existing swap at the start of the new hedge would have led to hedge ineffectiveness. This is because, to the extent that the swap had a non-zero fair value it would be regarded as effectively having an embedded loan which would not exist in the hedged item.

ii. The hedged item or hedging instrument no longer exists or is sold

For example, this would arise where an entity has closed out a US dollar forward position which it had previously designated as a hedging instrument for a forecast US dollar cash flow.

iii. There is no longer an economic relationship between the hedged item and hedging instrument

For example, an entity takes out a USD foreign currency (FX) derivative to hedge a currency exposure that was pegged to the USD. During the hedging period, the government in that country decides to eliminate the peg and let the currency float in the market. As a result, the economic relationship between the USD FX derivative and that currency exposure no longer exists. Consequently, IFRS 9 requires hedge accounting to be discontinued.

iv. The effect of credit risk starts to dominate the value changes that result from the economic relationship

For example, an entity enters into a commodity forward contract to hedge future commodity sales. Subsequently, due to deteriorating and volatile economic conditions, the counterparty to the commodity forward (a bank) is in financial distress and is near bankruptcy. The commodity derivative is an asset to the entity (i.e. liability to the bank). The change in fair value of the derivative due to the deterioration in the bank's credit status dominates the change in fair value the derivative. Consequently, IFRS 9 requires hedge accounting to be discontinued.

As noted above, although an entity can choose whether to apply hedge accounting, once an entity decides to apply hedge accounting to a particular transaction, it cannot voluntarily discontinue hedge accounting. This is different from IAS 39, which does permit this choice.

Another significant change from IAS 39, which is illustrated above in i. above, is that part of a hedge is discontinued when part of a hedged transaction is no longer probable.

Example 12: Partial discontinuation

Entity A takes out a forward contract to hedge the price of gold for the sale of 10,000oz of gold in six months and decides to apply hedge accounting. However three months later, unforeseen circumstances causes lower than expected production, and results in Entity A only expecting to produce 6,000oz of gold.

Under IFRS 9, Entity A discontinues hedge accounting for the 4,000oz of gold that will not be produced and continues hedging the 6,000oz of gold.

In contrast, IAS 39 would require the entire hedging relationship to be de-designated, with Entity A then having a choice of whether to establish a new hedge accounting relationship to hedge account the remaining 6,000oz of gold production.

BDO comment

The prohibition under IFRS 9 to discontinue hedge accounting might appear to be more onerous than the IAS 39 model.

However, the discontinuation requirements under the new model are more closely linked to the risk management activities of an entity.

Under IFRS 9 hedge accounting only ends when the economic hedge ends.

Under IAS 39, an entity may voluntarily discontinue hedge accounting at any time i.e. an entity can deliberately fail hedge accounting (e.g. by doing away with the hedge documentation) while continuing to economically hedge.

This brings the potential for an entity to discontinue hedge accounting in order to achieve a desired accounting result, which the IFRS 9 model eliminates.

10. OWN USE SCOPE EXCEPTION

IAS 39 *Financial Instruments: Recognition and Measurement* applies to certain contracts for the sale or purchase of non-financial items (e.g. commodities such as wheat, corn, iron ore etc.).

This includes contracts which contain a cancellation option, under which a cancellation payment is made based on any difference between the contract price and the market price of the commodity.

Others that fall within the scope of IAS 39 are arrangements where an entity takes delivery of the underlying item, but sells it within a short period after delivery in order to generate profits from short term market price movements. As an exception, contracts would be treated as executory contracts (rather than as derivatives at fair value through profit or loss) if they are entered into to meet the entity's own purchase, sale, or usage requirements (sometimes referred to as 'own use' contracts).

IFRS 9 *Financial Instruments* extends the fair value option to 'own use' contracts which permits them to be accounted for at fair value if this would eliminate or significantly reduce an *accounting mismatch*.

An *accounting mismatch* arises when, for example, assets and related liabilities are accounted for differently (one at fair value and the other at amortised cost) or where one is recognised on balance sheet and the other is not.

Although the International Accounting Standards Board (IASB) is still developing a macro-hedging model (principally for financial institutions – see section 2.3), the amendment to 'own use' contracts goes some way to assist producers of commodities (agriculture produce or minerals) that have a dynamic hedging strategy.

A situation where accounting for own use contracts at fair value would reduce or eliminate an accounting mismatch is as follows:

- The entity applies the measurement exception in paragraph 3 of IAS 2 *Inventories* and measures their inventories at net realisable value (agriculture or mineral producers) or fair value less costs to sell (commodity broker traders). Changes in those values are recognised in profit or loss.
- The entity enters into contracts to buy or sell the agricultural or mineral produce ('own use contracts'). Some of the contracts are at fixed prices and some are at market prices.
- To reduce its exposure to risk that arises from the fixed price contracts, the entity enters into derivatives in order to generate exposure to changes in market commodity prices for the amount of agricultural or mineral produce subject to the fixed price contracts. This will result in a 'net zero' risk position. The derivatives would be measured at fair value through profit or loss.

Under the amendment to IFRS 9, the fixed price own use contracts under this scenario can be measured at fair value through profit or loss, with the related changes in value offsetting the fair value changes from the commodity derivatives. Under IAS 39, profit or loss volatility will arise as the executory contracts that make up the 'net zero' risk position cannot be measured at fair value through profit or loss.

BDO comment

This proposed amendment is an effective way to deal with profit or loss volatility that currently arises for agriculture and commodity producers that manage their risk on a fair value basis.

Typically the hedged position (hedging volume) changes daily depending on the number of fixed and variable price supply or sales contracts that have been entered into. Applying fair value hedge accounting would mean constant de and redesignation of hedge positions, the need for which is eliminated by the fair value option.

Example 12: 'Own use' contracts at FVTPL

A soybean crusher enters into 10 contracts to purchase 100 million bushels of soybeans from 10 different farmers (10 million bushels per farmer) in 9 months time (at harvest).

6 contracts are at fixed prices and 4 contracts are at spot prices on the date of delivery.

The soybean crusher carries the soybean at net realisable value under the IAS 2.3a) measurement exception.

The soybean crusher also enters into sales contracts for delivery of crushed soybeans to its sole customer in 12 months time. The sales price is the spot price in 9 months time (and so the spot price at the date of delivery from the farmers) + 5% processing margin.

To ensure a stable profit margin the soybean crusher enters into 9 months exchange traded soybean futures for 60million bushels, which offset the 6 fixed price contracts. The economic effect is that all sales and purchases of soybeans will be at (or based on) the spot price in 9 months time.

Under IAS 39, the fixed price purchase contracts meet the 'own use' scope exception and are therefore accounted for as executory contracts and not recognised on balance sheet. However, the exchange traded futures contract is a derivative and is measured at fair value through profit or loss. This means that from an accounting perspective the soybean crusher would report profit or loss volatility because of the measurement mismatch between the fair value remeasurement of the derivatives used to manage the fluctuation in commodity prices and the fixed price contracts that are treated as being executory.

Under IFRS 9, the soybean crusher would be able to measure the fixed price 'own use' purchase contracts at fair value through profit or loss under the fair value option, effectively offsetting the fair value gains or losses from the soybean futures contracts and eliminating the related profit or loss volatility.

11. FINANCIAL INSTITUTIONS

Financial institutions commonly manage interest rate risk on a dynamic basis (with hedged items and hedging instruments changing on a continuous basis). The macro hedge accounting model is intended to deal with such dynamic risk management strategies and primarily affects financial institutions. However, the new general hedge accounting model in IFRS 9 *Financial Instruments* can still have an effect on financial institutions as discussed below.

11.1. Inflation risk

For inflation risk, IAS 39 *Financial Instruments: Recognition and Measurement* explicitly prohibits entities from designating inflation risk as a risk component for fixed rate financial instruments. IFRS 9 removes this prohibition.

Instead there is a rebuttable presumption in IFRS 9 that inflation is not a risk component that can be separately identified and reliably measured, meaning that it does not qualify to be a hedged risk (unless the inflation risk is contractually specified). However, that presumption can be rebutted in limited cases where inflation risk can be separately identified and reliably measured e.g. in a market where there is a sufficient liquidity for inflation-linked bonds that will allow a term structure of zero-coupon real interest rate curves to be constructed.

11.2. Credit risk

Entities that use credit derivatives (e.g. credit default swaps) to manage credit exposures arising from loans and/or loan commitments can, as an option, measure the related loans and/or loan commitments at fair value through profit or loss, subject to meeting both of the following criteria:

- The name of the borrower (or holder of the loan commitment) matches the reference entity of the credit derivative ('name matching')
- The seniority of the loan matches that of the instruments that can be delivered in accordance with the credit derivative.

If the above criteria are met, the loan or loan commitment can be designated at fair value through profit or loss at initial recognition or subsequently, or while it remains unrecognised, so that changes in its fair value will offset the changes in fair value of the credit derivative.

As an example, Bank X issues ABC Ltd with a loan commitment for CU10m for 2 years. ABC Ltd can draw down on the loan at any time during the 2 years.

To protect itself from losses should ABC Ltd draw down the loan and fail to make repayments, Bank X enters into a credit default swap for ABC Ltd, where if ABC Ltd has a credit loss event (e.g. insolvency, bankruptcy, failure to pay etc.) Bank X will receive a payment equal to the loss suffered (up to CU10m).

Under IFRS 9, Bank X can designate the loan commitment (which would otherwise not be recognised) at fair value through profit or loss to offset the changes in fair value of the credit default swap.

After a loan or loan commitment has been designated at fair value through profit or loss, that measurement is discontinued if the qualifying criteria are no longer met, and the financial instrument that gave rise to the credit risk is not otherwise required to be measured at fair value through profit or loss.

When designation at fair value through profit or loss ceases, the fair value of the financial instrument at that point becomes its new carrying amount. Subsequently, the measurement approach followed is the same as applied before the designation as at fair value through profit or loss (for example, amortised cost for a loan) with loan commitments or financial guarantee contracts being measured at the higher of the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and the new carrying amount at the date of discontinuation less cumulative amortisation.

BDO comment

This option (subject to the above qualifying criteria) is flexible, and can be applied at initial recognition or subsequently, and can also be a percentage of the nominal amount. This accounting provides better reflection of credit risk manager's activities as they actively manage the credit risk exposure that exists in their commercial loan portfolios.

11.3. Forwards as hedging instruments

IFRS 9 introduces an option for entities to amortise the forward points over the period of hedge and recognise the changes in forward points in other comprehensive income (see section 7.2). The change will effectively minimise profit or loss volatility for financial institutions that take out foreign currency forwards (more commonly referred to as 'funding swaps') to eliminate foreign currency risk when investing in foreign currency denominated investments.

As an example, Bank X operates in Country X and has local currency (LC) 100 six month term deposits from local residents of Country X at 3%. However, there are no suitable investments in Country X. Bank X then converts the CU100 into the currency of Country Y (FC) and then invests the money in FC denominated bonds for six months at 6%. At the same time, it enters into a foreign exchange forward contract, to convert the foreign currency back to its local currency at the end of 6 months, locking in a return over the next 6 months. Bank X will record the changes in the foreign currency loan arising from change in foreign exchange spot rates in accordance with IAS 21 *Effects of Changes in Foreign Exchange Rates* and record associated amounts in profit or loss. Under IFRS 9, Bank X can then designate the spot element of the forward as the hedging instrument to offset the foreign exchange spot rate changes from the foreign currency loan under IAS 21. Bank X would then amortise the initial forward points which would result in Bank X showing a stable net interest margin over the 6 month period. Under IAS 39, the changes in forward points are recognised in profit or loss which results in profit or loss volatility.

BDO comment

The option to defer the initial forward points and recognise subsequent changes in OCI will allow financial institutions with funding swaps (which are particularly popular for financial institutions in certain jurisdictions such as Asia) to better reflect their risk management strategy in their financial statements.

12. DISCLOSURES

The International Accounting Standards Board (IASB) introduced new disclosures in IFRS 7 *Financial Instruments: Disclosures* for the new hedge accounting model. It requires entities to disclose information on risk exposures being hedged and applies to exposures for which hedge accounting is applied. The new model requires, by risk category:

- Description of the risk management strategy (see section 12.1 below)
- Disclosure of information about the notional amount, timing of the cash flows and the average price or rate of the hedging instrument
- The effect that hedge accounting has had on the financial statements.

The new disclosure requirements are extensive and detailed, although they are only required to be made if they are material (whether from a quantitative and/or qualitative perspective). The specific disclosure requirements are required to be applied separately for each risk (e.g. interest rate risk, foreign currency risk and commodity risk) and by each type of hedge (fair value hedge, cash flow hedge and net investment hedge).

12.1. The risk management strategy

Entities are required to disclose their risk management strategy for each type of risk that has been hedged and for each type of hedge accounting that has been applied. This includes, for example:

- How each risk arises
- How the entity manages each risk (including whether the entity is hedging the entire item or a risk component and why)
- The extent to which the risk exposure has been hedged.

In describing the risk management strategy, entities are also required to disclose:

- The hedging instruments used and how they are used
- The economic relationship between the hedged item and the hedging instrument
- How the hedge ratio is established and the sources of hedge effectiveness.

If a specific risk component is designated, disclosure is required about:

- How the risk component has been determined, and
- How the risk component relates to the item (e.g. the risk component might historically have covered on average 80% of changes in the fair value of the whole item).

12.2. The amount, timing and uncertainty of future cash flows of the hedging instrument

IFRS 7 requires entities to provide:

- A profile of the timing of the nominal amount of the hedging instrument
- If applicable, the average price or rate (e.g. strike or forward prices) of the hedging instruments (refer to section 16 Appendix B for an example).

For dynamic hedging relationships (i.e. where hedged items and the hedging instruments frequently change resulting in frequent resets of the hedging relationship) the above disclosure is not required. Instead, the following disclosures need to be made:

- Information about the ultimate risk management strategy
- How the entity has reflected its ultimate risk strategy by using hedge accounting and designating those particular hedging relationships
- Indicate how frequently the hedging relationships are discontinued and restarted.

IFRS 7 also requires the following disclosures for each risk category:

- A description of the sources of hedge ineffectiveness that are expected to affect a hedging relationship during its term
- If other sources of hedge ineffectiveness emerge during the period hedge, disclosure of those sources together with an explanation of the resulting hedge ineffectiveness.

For cash flow hedges, IFRS 7 also requires disclosure of any forecast transactions which are no longer expected to occur.

12.3. The effects of hedge accounting on financial position and performance

12.3.1. Hedging instruments

IFRS 7 requires the following disclosures about hedging instruments in a tabular format (IFRS 7.24A), disclosed separately for each risk category and for each type of hedge:

- The carrying amount (disclosed separately for financial assets and liabilities)
- The line item in the statement of financial position that includes the hedging instrument
- Changes in fair value used for calculating hedge ineffectiveness
- Nominal amounts.

12.3.2. Hedged items

For fair value hedges, IFRS 7 requires the following disclosures about hedged items in a tabular format, disclosed separately for each risk category (IFRS 7.24B (a) & C (a)):

- The carrying amount of the hedged item (disclosed separately for assets and liabilities)
- The accumulated amount of fair value hedge adjustments included in the carrying amount of the hedged item (disclosed separately for assets and liabilities)
- The line item in the statement of financial position that includes the hedged item
- The change in value of the hedged item used as the basis for calculating hedge ineffectiveness for the period
- Accumulated amount of fair value hedge adjustments remaining for any hedged items where hedge accounting has been discontinued
- The amount of hedge ineffectiveness recognised in profit or loss (or other comprehensive income (OCI) for hedges of an equity instrument at fair value through OCI – refer to section 6.3)
- The line item in the statement of comprehensive income that includes the recognised hedge ineffectiveness.

For cash flow hedges and hedges of net investments in foreign operations, IFRS 7 requires the following disclosures on hedged items in a tabular format, disclosed separately for each risk category (IFRS 7.24B (b)&C (b)):

- The change in value of the hedged item that has been used as the basis for recognising hedge ineffectiveness for the period
- The balance in the cash flow hedge (CFH) reserve and the foreign currency (FX) translation reserve for any continuing hedge relationships
- The balances remaining in the cash flow hedge reserve and the foreign currency translation reserve for any discontinued hedge relationships
- Hedging gains or losses that were recognised in OCI in the reporting period
- The amount of hedge ineffectiveness recognised in profit or loss
- The line item in the statement of comprehensive income that includes recognised hedge ineffectiveness
- The amount recycled from the CFH reserve or the FX translation reserve into profit or loss, with separate disclosure for:
 - Where the recycling is a result of the entity no longer expecting a forecast cash flow to occur, and
 - Where the recycling is because the hedged item has affected profit or loss.
- The line item in the statement of comprehensive income that includes recycled amounts
- For hedges of net positions, the hedging gains and losses recognised in a separate line item in the statement of comprehensive income.

IFRS 7 also required a reconciliation of each component of equity (IFRS 7.24E). For the cash flow hedge reserve, separate disclosure is required for:

- Hedging gains or losses that were recognised in OCI for the period
- Hedging gains or losses that have been recycled to profit or loss or that have been reclassified as a 'basis adjustment' and capitalised into the cost of the hedged item.

For the time value of options reserve, forward points reserve and the foreign currency basis spread reserve, a reconciliation of the opening balance to the closing balance showing separately (and with separate reconciliations for each risk category):

- The time value of options/forward points/foreign currency basis spread that are being used to hedge transaction related hedged items
- The time value of options that are being used to hedge time period related hedged items.

Refer to section 16 Appendix B for an example of the above disclosures.

13. INTERACTION WITH 'MACRO HEDGING' ACTIVITIES

As noted in section 2, the International Accounting Standards Board (IASB) is still in the process of developing a new macro hedge accounting model. Therefore, for entities that engage in portfolio hedge accounting of interest rate risk (i.e. fair value hedges of interest rate risk for a portfolio of financial assets and financial liabilities), the new model provides entities with an accounting policy choice to either:

- i. Apply the new hedge accounting requirements of IFRS 9 *Financial Instruments*, or
- ii. Continue to apply the existing hedge accounting requirements in IAS 39 *Financial Instruments: Recognition and Measurement*.

The accounting for fair value hedges of the interest rate exposure of a portfolio of financial assets or financial liabilities in IAS 39 would still be available to entities that apply the new IFRS 9 hedge accounting model.

The new hedge accounting related disclosure requirements that are included in IFRS 7 *Financial Instruments: Disclosures* apply to all entities applying IFRS 9 (as amended in November 2013, and therefore including the new hedge accounting model).

However, there is a choice of whether to adopt IFRS 9 as issued in 2009 (classification and measurement of financial assets only), IFRS 9 as issued in 2010 (classification and measurement of financial assets and financial liabilities, and derecognition) or IFRS 9 as issued in 2013. If an entity adopts IFRS 9 as issued in 2013, it has a further option of continuing to apply the IAS 39 hedge accounting requirements (see BDO comment after the next table).

Accordingly, the following permutations of the requirements are permitted:

		IFRS 9 'General' hedge accounting Model	IAS 39 'General' hedge accounting Model	IAS 39 'Macro' portfolio interest rate hedging model	IFRS 7 New hedge accounting related disclosures
Current requirements	IAS 39 <i>Financial Instruments: Recognition and Measurement</i>		X	X	
Available for early application	IFRS 9 <i>Financial Instruments</i> (November 2009 or October 2010)		X	X	
Available for early application	IFRS 9 <i>Financial Instruments</i> (November 2013)	X (optional)	X (optional)	X (optional)	X (If IFRS 9 'General' hedge accounting model is applied)

BDO comment

The original draft requirements allowed entities to apply IAS 39 instead of the new model for 'macro' fair value hedge of interest rate exposure (portfolio hedges of financial assets or financial liabilities) as an interim solution until the macro-hedging project is complete. However, some financial institutions were concerned that:

- There is a risk that existing IAS 39 compliant portfolio hedge accounting practices such as portfolio cash flow hedges may not be possible under the new model, and*
- There is a risk that entities will be required to change their IAS 39 compliant portfolio hedge accounting practice twice (once upon adoption of the finalisation of the new general model and then again when the macro-hedging project is complete).*

After redeliberation the IASB has decided to permit an accounting policy choice of either applying the new model or retaining the existing IAS 39 requirements. The accounting policy choice would:

- Provide certainty that IAS 39 compliant practices of designating hedging relationships for portfolio hedging remain available (until the project on accounting for macro-hedging is completed), and*
- Avoid costs of assessing whether those practices are IFRS 9 compliant and the risk of entities having to change those practices twice (i.e. as a consequence of adopting IFRS 9 and, later on, the requirements resulting from the project on accounting for macro hedging).*

14. TRANSITION AND EFFECTIVE DATE – IFRS 9 HEDGE ACCOUNTING REQUIREMENTS

The International Accounting Standards Board (IASB) has left the effective date for IFRS 9 *Financial Instruments* open until all the other outstanding phases of IFRS 9 have been finalised. Early application of the 2013 hedge accounting requirements is permitted provided the classification and measurement requirements in IFRS 9 are also adopted at the same time.

The new hedge accounting requirements would apply prospectively with limited exceptions (see below). The following practical expedients are allowed at transition:

- Entities can consider applying the new model, immediately after ceasing to apply IAS 39 *Financial Instruments: Recognition and Measurement* (i.e. de-designate the old IAS 39 hedging relationship and start a new hedging relationship under the new model)
- For rebalancing, the starting point will be the hedge ratio used under IAS 39 (the designated volume of hedging instrument and hedged items under IAS 39).

Retrospective application applies to the accounting for:

- The time value of options where the entity has designated only the intrinsic element of the option as the hedging instrument (section 7.1), and
- Forward points and foreign currency basis spreads (sections 7.2 and 7.3) where the entity has designated only the spot element of the forward as the hedging instrument.

The above retrospective application applies to those types of hedging relationships that exist at the beginning of the comparative period (or later). This means that the previously recognised changes in time in value or forward points or foreign currency basis spreads under the existing IAS 39 model will be reclassified from retained earnings to accumulated OCI.

For contracts that fall under the 'own use' scope exception (section 10) entities may make a one off election for all existing contracts (on an all or nothing basis for similar contracts) to account for these contracts at fair value (by extending the fair value option in IFRS 9 to these own use scope contracts) if applying fair value accounting to these contracts eliminates or significantly reduces an accounting mismatching.

BDO comment

Prospective application means that entities cannot go back and re-designate risk components of non-financial items, aggregated exposures and groups and net positions to existing hedging relationships. However, entities would be able to voluntarily discontinue the existing hedging relationship under IAS 39 and re designate under the new model from the date of initial application.

15. APPENDIX A – IAS 39 AND IFRS 9 COMPARISON

The following table provides a high level summary of the main changes introduced by IFRS 9 *Financial Instruments* (2013) in comparison with the requirements of IAS 39 *Financial Instruments: Recognition and Measurement*.

	IAS 39 requirement	New model under IFRS 9
Hedge effectiveness testing <i>(Section 4)</i>	<p>Must meet the quantitative retrospective and prospective hedge effectiveness assessment within the 80-125% threshold to qualify for hedge accounting.</p>	<p>Retrospective effectiveness testing is no longer required in order to qualify for hedge accounting. Permits qualitative hedge effectiveness test. Must meet three criteria to qualify for hedge accounting:</p> <ul style="list-style-type: none"> – An economic relationship must exist between the hedge item and the hedging instrument – The effect of credit risk does not dominate the fair value changes – Hedge ratio is designated based on actual quantities of hedge item and the hedging instruments.
Rebalancing <i>(new concept)</i> <i>(Section 5)</i>	<p>If hedge ratio is adjusted (i.e. if the quantities of the hedged item or hedging instrument changes) for risk management purposes, must de-designate (terminate) the current hedge relationship and re-designate (start) a new hedge relationship.</p>	<p>If the quantity of the hedged item or hedging instrument changes for risk management purposes, the current hedge relationship continues.</p> <p>However the hedge ratio for hedge accounting purposes must change to align with the new hedge ratio for risk management purposes, i.e. must adjust the hedge ratio prospectively if the hedge ratio is adjusted for risk management purposes.</p>
Risk components for non-financial items <i>(Section 6.1)</i>	<p>Not an eligible hedged item.</p>	<p>Eligible hedged item if the risk component is separately identifiable and reliably measurable.</p>
Aggregated exposures <i>(Section 6.2)</i>	<p>Derivatives cannot be designated as a hedged item. Therefore, any exposure that contains a derivative cannot be designated as a hedged item.</p>	<p>Can designate an exposure that combines a derivative and a non-derivative known as an aggregated exposure as a hedged item, provided that aggregated exposure is managed as one exposure.</p>

	IAS 39 requirement	New model under IFRS 9
Discontinuation (Section 9)	Can discontinue hedge accounting at any time.	Voluntary discontinuation not permitted. Can only discontinue where the qualifying criteria are no longer met.
Inflation risk (Section 11.1)	Inflation risk is not an eligible risk component unless it is contractually specified.	Rebuttable presumption that non-contractually specified inflation risk will not usually qualify as an eligible hedged item.
Own use contracts (Section 10)	Contracts for the sale or purchase of a non-financial item that are for own use are outside the scope of IAS 39.	Option to account for 'own use' contracts at fair value through profit or loss if it eliminates an accounting mismatch.
Hedges of groups (Section 8)	Groups permitted only if the fair value of the items in the group move in approximately proportionally to the fair value group as a whole.	Restriction removed.
Fair value hedge of a group with offsetting positions (Section 8)	Not allowed.	Permitted.
Cash flow hedge of a group with offsetting/net positions (Section 8)	Not allowed.	Permitted for foreign exchange risk (FX). Hedge documentation at inception must specify the nature and amount.
Hedges of credit risk using credit derivatives (Section 11.2)	General criteria for risk component apply. No specific exception.	Can elect to account for a loan or loan commitment at FVTPL at any time and for a proportion of the instrument. The election can also be revoked.
Equity investments at FVTOCI under IFRS 9 (Section 6.3)	N/A	Eligible hedged item. Ineffectiveness recorded in OCI.

	IAS 39 requirement	New model under IFRS 9
Time value of options <i>(Section 7.1)</i>	<p>When the intrinsic value component of the option is designated as the hedging instrument, the changes in the time value component of the option is recognised in profit or loss like a trading gain or loss.</p>	<p>When the intrinsic value component of the option is designated as the hedging instrument, the changes in the time value component of the option is recognised in other comprehensive income (OCI).</p> <p>The initial time value component of the option is deferred in OCI and is either amortised to profit or loss or capitalised into the hedged item depending on the nature of the hedged item.</p>
Forward points in forward contracts <i>(Section 7.2)</i> <i>(Section 11.3)</i>	<p>When the spot element is designated as the hedging instrument, the changes in forward points are recognised in profit or loss like a trading gain or loss.</p>	<p>When the spot element is designated as the hedging instrument, entities have an option to recognise the changes in forward points in OCI.</p> <p>The initial forward points are deferred in OCI and is amortised over the term of the hedging transaction.</p>
Foreign currency (FX) basis spread in foreign currency swap contracts <i>(Section 7.3)</i>	<p>Changes in FX basis spread are treated as part of hedge 'ineffectiveness'.</p>	<p>Entities have an option to recognise changes in foreign currency spread in OCI. The initial FX basis spread is deferred in OCI and is amortised over the term of the hedging transaction.</p>
Cash instruments measured at FVTPL <i>(Section 7.4)</i>	<p>Only derivatives can be designated as hedging instruments (except cash instruments measured at amortised cost can be a hedging instrument for hedging FX).</p>	<p>Cash instruments measured at FVTPL are eligible hedging instruments.</p>

16. APPENDIX B – IFRS 7 DISCLOSURES

Appendix B provides an example of some of the disclosures required by IFRS 7 *Financial Instruments: Disclosures* for the hedge accounting model in IFRS 9 *Financial Instruments*. The example disclosures are based on the requirements of IFRS 7.23-24E.

Timing profile of the nominal amount of the hedging instruments (IFRS 7.23B)

Hedging instruments

i. Cash flow hedges

	<6 months	6-12 months	1-2 years	2-5 years	5-10 years
<i>Commodity price risk</i>					
Forward sales contracts	XXX	XXX	XXX	-	-
Options	XXX	XXX	XXX	-	-
<i>Foreign exchange price risk</i>					
Forward contracts	XXX	XXX	XXX	-	-
<i>Interest rate risk</i>					
Interest rate swaps	XXX	XXX	XXX	XXX	XXX

ii. Fair value hedges

	<6 months	6-12 months	1-2 years	2-5 years	5-10 years
<i>Foreign exchange price risk</i>					
Forward contracts	XXX	XXX	XXX	-	-
<i>Interest rate risk</i>					
Interest rate swaps	XXX	XXX	XXX	XXX	XXX

iii. Net investment hedges

	<6 months	6-12 months	1-2 years	2-5 years	5-10 years
<i>Foreign exchange price risk</i>					
Foreign currency loans	XXX	XXX	XXX	XXX	-

Average price or rate of the hedging instruments (IFRS 7.23B)

i. Cash flow hedges

Average price or strike price	
<i>Commodity price risk</i>	
Forward sales contracts	XXX
Options	XXX
<i>Foreign exchange price risk</i>	
Forward contracts	XXX
<i>Interest rate risk</i>	
Interest rate swaps	XXX

ii. Fair value hedges

Average price or strike price	
<i>Foreign exchange price risk</i>	
Forward contracts	XXX
<i>Interest rate risk</i>	
Interest rate swaps	XXX

Effect of hedge accounting on financial position and performance

Hedging instruments

i. Cash flow hedges (IFRS 7.24A)

	Nominal amount	Carrying amount (assets)	Carrying amount (liabilities)	Line item in the statement of financial position where the hedging instrument is located	Changes in fair value used for calculating hedge ineffectiveness during the period
<i>Commodity price risk</i>					
Forward sales contracts	XXX	XXX	XXX	Line item YYY	XX
Options	XXX	XXX	XXX	Line item YYY	XX
<i>Foreign exchange price risk</i>					
Forward contracts	XXX	XXX	XXX	Line item YYY	XX
<i>Interest rate risk</i>					
Interest rate swaps	XXX	XXX	XXX	Line item YYY	XX

ii. Fair value hedges

	Nominal amount	Carrying amount (assets)	Carrying amount (liabilities)	Line item in the statement of financial position where the hedging instrument is located	Changes in fair value used for calculating hedge ineffectiveness during the period
<i>Foreign exchange price risk</i>					
Forward contracts	XXX	XXX	XXX	Line item YYY	XX
<i>Interest rate risk</i>					
Interest rate swaps	XXX	XXX	XXX	Line item YYY	XX

iii. Net investment hedges

	Nominal amount	Carrying amount (assets)	Carrying amount (liabilities)	Line item in the statement of financial position where the hedging instrument is located	Changes in fair value used for calculating hedge ineffectiveness during the period
<i>Foreign exchange price risk</i>					
Foreign currency loan	XXX	XXX	XXX	Line item YYY	XX

Hedged items

i. Cash flow hedges (IFRS 7.24B (b))

	Value change in the hedged item	Cash flow hedge reserve
<i>Commodity price risk</i>		
Forecast sales	XXX	XXX
Discontinued forecast sale hedges	N/A	XXX
<i>Foreign exchange price risk</i>		
Forecast purchases	XXX	XXX
<i>Interest rate risk</i>		
Floating rate borrowings	XXX	XXX

ii. Net investment hedges (IFRS 7.24B (b))

	Value change in the hedged item	Net investment hedge reserve
<i>Foreign exchange price risk</i>		
Overseas subsidiary	XXX	XXX

iii. Fair value hedges (IFRS 7.24B (a))

	Carrying amount of the hedged item (assets)	Carrying amount of the hedged item (liabilities)	Accumulated amount of hedge adjustment included in the carrying amount (assets)	Accumulated amount of hedge adjustment included in the carrying amount (liabilities)	Line item in the statement of financial position which the hedged item is included	Change in value used for calculating hedge ineffectiveness for the period
<i>Foreign exchange price risk</i>						
Firm commitments	XXX	XXX	XXX	XXX	Line item YYY	XXX
<i>Interest rate risk</i>						
Fixed rate borrowing	XXX	XXX	XXX	XXX	Line item YYY	XXX

NOTE: If an entity has a fixed rate borrowing for it had previously applied fair value hedge accounting, disclose the accumulated amount of fair value hedge adjustment that have not yet been amortised.

Hedge effectiveness

i. Fair value hedges (IFRS 7.24C (a))

	Ineffectiveness recognised in profit or loss		Line items in profit or loss (that include hedge ineffectiveness)	
Interest rate risk	XXX		Line item YYY	
Foreign exchange risk	XXX		Line item YYY	

ii. Cash flow hedges (IFRS 7.24C (b))

	Hedging gain or loss recognised in OCI (IFRS 7.24C (b)(i))	Hedge ineffectiveness recognised in profit or loss (IFRS 7.24C (b)(iii))	Line item in the comprehensive income that includes hedge ineffectiveness (IFRS 7.24C (b)(iii))	Amount reclassified to P&L because hedged future cash flows are no longer expected to occur (IFRS 7.24C (b)(iv))	Amount reclassified to P&L because hedged item has affected P&L (IFRS 7.24C (b)(v))	Line item that includes the reclassification adjustments (IFRS 7.24C (b)(v))	Hedging gain or loss recognised in separate line item for hedges of net position (IFRS 7.24C (b)(vi))
Commodity price risk							
Forecast sales	XXX	XXX	Line item YYY	N/A	Line item YYY	Line item YYY	N/A
Discontinued forecast sale hedges	N/A	N/A	N/A	XXX	Line item YYY	N/A	N/A

Foreign exchange price risk

Forecast purchases	XXX	XXX	Line item YYY	N/A	Line item YYY	Line item YYY	N/A
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Interest rate risk

Floating rate borrowings	XXX	XXX	Line item YYY	N/A	Line item YYY	N/A	N/A
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iii. Net investment hedges (IFRS 7.24C (b))

	Hedging gain or loss recognised in OCI (IFRS 7.24C (b)(i))	Hedge ineffectiveness recognised in profit or loss (IFRS 7.24C (b)(iii))	Line item in the comprehensive income that includes hedge ineffectiveness (IFRS 7.24C (b)(iii))	Amount reclassified to P&L because hedged future cash flows are no longer expected to occur (IFRS 7.24C (b)(iv))	Amount reclassified to P&L because hedged item has affected P&L (IFRS 7.24C (b)(iv))	Line item that includes the reclassification adjustments (IFRS 7.24C (b)(v))
Foreign exchange price risk						
Overseas subsidiary	XXX	XXX	Line item YYY	N/A	Line item YYY	N/A

Reconciliation of reserves

i. Cash flow hedge reserve (IFRS 7.24E (a))

	Commodity price risk	Foreign exchange rate risk	Interest rate risk
<i>Opening balance</i>	XXX	XXX	XXX
Hedging gain or loss	XXX	XXX	XXX
Amount reclassified to P&L because the hedged item affected P&L	XXX	XXX	XXX
Amount reclassified to P&L because the hedged item is no longer expected to occur	XXX	N/A	N/A
Amount transferred as a result of basis adjustment	XXX	XXX	N/A
Amount reclassified to P&L because hedging loss not expected to be recovered in future	N/A	N/A	N/A
<i>Closing balance</i>	XXX	XXX	XXX

ii. Net investment hedge reserve (IFRS 7.24E (a))

	Foreign exchange rate risk
<i>Opening balance</i>	XXX
Hedging gain or loss	XXX
Amount reclassified to P&L because the hedged item affected P&L	-
<i>Closing balance</i>	XXX

iii. Time value of options reserve (IFRS 7.24E (a))

	Commodity price risk
<i>Opening balance</i>	XXX
<i>Changes due to transaction related hedged items:</i>	
Changes due to fair value of changes in time value	XXX
Amount capitalised to the cost of the hedge item	XXX
<i>Changes due to time period elated hedged items:</i>	
Changes due to fair value of changes in time value	XXX
Amount reclassified to P/L for amortisation	XXX
<i>Closing balance</i>	XXX

NOTE: The above disclosure is also require for forward points and foreign currency basis spreads if an entity chooses to account for the changes in forward points and foreign currency basis spreads.

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For further information about how BDO can assist you and your organisation, please get in touch with one of our key contacts listed below. Alternatively, please visit [www.bdointernational.com/Services/Audit/IFRS/IFRS Country Leaders](http://www.bdointernational.com/Services/Audit/IFRS/IFRS%20Country%20Leaders) where you can find full lists of regional and country contacts.

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